

*United States Court of Appeals  
for the Second Circuit*



**APPENDIX**



75-4030

To be argued by  
GEORGE ROWE, JR.

B  
P/  
S

United States Court of Appeals  
For the Second Circuit

Docket Number  
75-4030

INTERNATIONAL FLAVORS & FRAGRANCES INC.,  
*Petitioner-Appellant,*  
*against*

COMMISSIONER OF INTERNAL REVENUE,  
*Respondent-Appellee.*

ON APPEAL FROM THE UNITED STATES TAX COURT

APPENDIX

FULTON, WALTER & DUNCOMBE  
*Attorneys for Petitioner-Appellant*  
30 Rockefeller Plaza  
New York, New York 10020  
(212) 586-0700

GEORGE ROWE, JR.  
MICHAEL J. GAYNOR  
*Of Counsel*



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**PAGINATION AS IN ORIGINAL COPY**

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UNITED STATES TAX COURT  
GENERAL DOCKET

1

7768-70

DOCKET NO. \_\_\_\_\_

INTERNATIONAL FLAVORS & FRAGRANCES INC. West 57th Street New York, New York, 10019		APPEARANCES FOR PETITIONER: George Rowe, Jr. (Fulton, Waiter & Cuncombe) 30 Rockefeller Plaza, New York, NY, 10020.
vs. (John P. Winandy, Vice-Pres. Finance)		NAME: Michael Joseph Gaynor (App. 7/19/73) ADDRESS: 30 Rockefeller Plaza, New York, New York 10020
MISSIONER OF INTERNAL REVENUE,		RESPONDENT.

Date Month Day Year	Filings and Proceedings	Action	Served
c. 21, 1970	PETITION FILED: FEE PAID	DEC 21 1970	Dec. 30, 1970
c. 21, 1970 b 23, 1971	REQUEST by petr. for trial at New York City ANSWER filed by Resp	GRANTED: Dec. 30, 1970	Dec. 30, 1970 Feb 25, 1971
Feb. 9, 1973	NOTICE of Trial on April 30, 1973 at New York, New York.		Feb. 9, 1973
Apr. 30, 1973	TRIAL at New York, New York before Judge Quealy.  STIPULATION of Facts filed.  Subpoena Duces Tecum filed.  Partial Trial C.A.V. JUDGE QUEALY		
May 7, 1973	TRANSCRIPT of April 30, 1973 received.		
June 27, 1973	ORDER, that this case is calendared for further trial at New York, N.Y. on July 19, 1973.		JUN 29 1973
July 19, 1973	TRIAL at New York, N.Y. before Judge Quealy George Rowe, Jr., Michael Gaynor, recognized for this case.  Supplemental Stipulation of Facts w/Exhibits filed		
	Entry of App. for Petr. by Michael Joseph Gaynor filed 7/19/73.		JUL 25 1973
	BRIEFS due Oct. 1, 1973		
	REPLY BRIEFS due Nov. 1, 1973		
	SUBMITTED TO JUDGE QUEALY		

(continued to page 2)

7700  
KET NO. \_\_\_\_\_

(Continuation)

INTERNATIONAL FLAVORS & FRAGRANCES, INC.,		PETITIONER	PAGE 2
Date Month Day Year	Filings and Proceedings Judge Quealy	Action	Served
Oct. 13, 1973	TRANSCRIPT of July 19, 1973 rec'd.		
Oct. 21, 1973	MOTION by Petr. to extend time to Oct. 31, 1973 within which to file brief.	GRANTED Sept. 21, 1973	SEP 25 1973
Oct. 31, 1973	BRIEF FOR PETITIONER filed.		NOV 1 1973
Nov. 1, 1973	BRIEF for Resp. filed.		NOV 1 1973
Nov. 21, 1973	MOTION by Petr. to extend time to Dec. 17, 1973 within which to file Reply Brief.	GRANTED Nov. 21, 1973	NOV 21 1973
Dec. 17, 1973	REPLY BRIEF for Petitioner filed.		DEC 18 1973
Dec. 17, 1973	REPLY BRIEF for Resp. filed.		DEC 18 1973
May 16, 1974	FINDINGS OF FACT AND OPINION filed, Judge Quealy. Decision will be entered under Rule 155.		MAY 16 1974
Oct. 9, 1974	AGREED COMPUTATION filed.		
Oct. 15, 1974	DECISION ENTERED, Judge Quealy.		Oct. 15, 1974
APPELLATE PROCEEDINGS			
Oct. 23, 1974	MOTION to fix amount of bond filed by Petr.		Oct. 24, 1974
Oct. 24, 1974	ORDER fixing amount of bond at \$114,995.40.		Oct. 24, 1974
Jan. 7, 1975	Surety bond in the amount of \$114,995.40, with Insurance Company of North America, as surety, approved and ordered filed.		Jan. 7, 1975
Jan. 7, 1975	NOTICE OF APPEAL to U.S.C.A., 2nd Cir., filed by Petr.		Jan. 7, 1975
Jan. 7, 1975	NOTICE of Filing with copy of notice of appeal sent to Chief Counsel, Mr. Meade Whitaker.		Jan. 7, 1975
Jan. 7, 1975	NOTICE, to parties, of assembling and date for transmission of record.		Jan. 7, 1975

UNITED STATES TAX COURT

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INTERNATIONAL FLAVORS & FRAGRANCES INC., )  
Petitioner, )  
v. ) Docket No. 7768-70  
COMMISSIONER OF INTERNAL REVENUE, )  
Respondent. )

STIPULATION OF FACTS

The parties hereby stipulate and agree that for the purpose of this case the following facts and exhibits attached hereto and made a part thereof shall be taken as true, subject to the rights of the parties to introduce other and further evidence not inconsistent with the facts herein and without prejudice to the right of either party to object, at trial, to portions of said stipulation or exhibits as they may deem to be irrelevant or immaterial.

1. International Flavors & Fragrances Inc. (IFF), a New York corporation with its principal place of business at 521 West 57th Street, New York, New York 10019, is engaged in creating and manufacturing flavor and fragrance products used by other manufacturers to impart or improve flavor or fragrance in a variety of consumer products. A United States Corporation Income Tax Return for the taxable year 1967 was filed with the

District Director of Internal Revenue, Manhattan District, New York, New York. Attached hereto as Joint Exhibits 1-A and 2-B are copies of Form 1120, U. S. Corporation Income Tax Return and Form 2952, Information Return with Respect to Controlled Foreign Corporations of IFF for the taxable year 1967.

2. Attached hereto as Joint Exhibit 3-C is a copy of an agreement, dated December 29, 1966 by and between IFF and First National City Bank, 399 Park Avenue, New York, New York.

3. Attached as Joint Exhibits 4-D through 8-M, respectively, are copies of the documents described below:

<u>Exhibit No.</u>	<u>Description</u>
4-D	Letter, dated December 20, 1967, from IFF to Amsterdam Overseas Corporation.
5-E	Letter, dated December 20, 1967, from IFF to First National City Bank.
6-F	Letter, dated December 20, 1967, from Amsterdam Overseas Corporation to First National City Bank.
7-G	Letter, dated December 20, 1967, from First National City Bank to Amsterdam Overseas Corp.
8-H	Contract No. S1273, dated December 20, 1967, by and between First National City Bank and Amsterdam Overseas Corporation.

4. Attached as Joint Exhibits 9-I to 12-L, inclusive, respectively, are copies of the documents described below:

<u>Exhibit No.</u>	<u>Description</u>
9-I	Advice of Amsterdam Overseas Corp. to IFF, dated December 21, 1967.
10-J	Check No. 43772, dated December 21, 1967, in the amount of \$387,000.00, drawn by Amsterdam Overseas Corp. on its account at Morgan Guaranty Trust Co. payable to the order of IFF.
11-K	The address side of envelope of Amsterdam Overseas Corp. addressed to IFF and bearing the postage meter date Dec. 21, 1967.
12-L	IFF Memorandum, dated December 26, 1967 from Herbert Reid to Louis Davids.

5. The Exchange Rate in terms of United States dollars for British pound sterling was as follows:

	<u>High</u>	<u>Low</u>	<u>Final</u>
Dec. 29, 1966	2.7920	2.7916	2.7918
Dec. 20, 1967	2.4081	2.4057	2.4079
Jan. 3, 1968	2.4072	2.4060	2.4070

6. Attached as Joint Exhibit 13-M is a copy of the Financial Statement of Amsterdam Overseas Corporation for the year 1967.

*Geo. R. Gibbs*

Counsel for Petitioner

((Sgd) LAWRENCE B. GIBBS - EHH

LAWRENCE B. GIBBS,  
Acting Chief Counsel,  
Internal Revenue Service.

UNITED STATES TAX COURT

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INTERNATIONAL FLAVORS & FRAGRANCES INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 7763-70

SUPPLEMENTAL STIPULATION OF FACTS

The parties hereby stipulate and agree that for the purposes of this case the following facts and exhibits attached hereto and made a part hereof may be taken as true, subject to the rights of the parties to introduce other and further evidence not inconsistent with this stipulation and preserving the parties' rights to object, at the time of trial, to any and all portions of said stipulation as they may deem to be irrelevant or immaterial.

7. Attached as Joint Exhibit 14-N are copies of schedules of inter-company management and research charges between IFF and subsidiaries for the years 1965 through 1967.

8. Attached as Joint Exhibit 15-O are copies of statements of financial position, reconciliation of sales and inter-company receivables and payables of IFF for the years ended December 31, 1965 through December 31, 1967.

9. Attached as Joint Exhibit 16-P is a copy of a schedule of the obligations in pounds sterling incurred by IFF on account of

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transactions in the years 1966, 1967 and 1968, with dates of payment, check numbers, invoice numbers and the amount of pounds sterling as shown.

10. Attached as Joint Exhibit 17-Q are copies of the financial statements of International Flavors and Fragrances IFF (Great Britain) Limited (IFF (G.B.)) for the years ended December 31, 1967 through December 31, 1968, audited by Kidsons, Taylor & Co., with comparative figures for the year ended December 31, 1966 shown on the statements for 1967.

11. Attached as Joint Exhibit 18-R is a copy of an agreement made as of January 1, 1963 by and between IFF and IFF (G.B.).

12. Attached as Joint Exhibit 19-S are copies of quarterly invoices showing amounts due and payments received by IFF from IFF (G.B.) pursuant to the agreement made as of January 1, 1963 (Ex. 18-R) for the quarter ended December 30, 1965 and for the years 1966 and 1967.

13. Attached as Joint Exhibits 20-T, 21-U and 22-V, respectively, are copies of bank statements for account number 02735211-2733 of IFF at First National City Bank for the periods set forth below:

<u>Exhibit No.</u>	<u>Commencing</u>	<u>Period</u>	<u>Ending</u>
20-T	12/2/65		2/1/66
21-U	12/1/66		2/3/67
22-V	12/6/67		1/4/68

14. Attached as Joint Exhibit 23-W is a copy of a statement of financial position and a statement of income and retained earnings of IFF (G.B.) for the year ended December 31, 1966.



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Counsel for Petitioner

(Sgd) LAWRENCE B. GIBBS - EHH

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LAWRENCE B. GIBBS  
Acting Chief Counsel  
Internal Revenue Service

UNITED STATES TAX COURT  
FIRST NATIONAL CITY BANK

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December 29, 1966

IN REPLY PLEASE REFER TO INITIALS, P. C.

International Flavors &  
Fragrances Inc.  
521 West 57th Street  
New York, N. Y. 10019  
Att: Mr. Louis Davids, Treasurer

279  
75  
1395 279  
1953 09  
-20925- 27691

WE CONFIRM HAVING TODAY BOUGHT FROM YOU THE FOREIGN EXCHANGE DESCRIBED HEREUNDER.  
SUBJECT TO THE CONDITIONS SET FORTH ON THE REVERSE SIDE HEREOF.

AMOUNT £ 1,100,000-0-0 TENOR Cable London  
DELIVERY January 3, 1968 RATE 2.7691

BROKER (IF ANY)

KINDLY CONFIRM THE ABOVE ON THE COPY HEREOF AND RETURN TO US.

  
Alice O. Reckling  
AUTHORIZED SIGNATURE

Ref. No. 7768-76

## CONDITIONS

I. Should the New York market price of the foreign exchange be more at any time than the rate we are to pay you therefor, you shall, upon our request at any time, promptly deposit with us at this office, as security for your obligation, cash or its equivalent in an amount sufficient to cover the amount of the increase. In default thereof, we may, in our discretion at any time thereafter, cancel the purchase, whereupon you will be indebted to us for, and shall pay us upon demand, an amount equal to any excess of the said market price of such foreign exchange on the date of cancellation over the purchase price.

II. Unless the purchase is cancelled as provided above, the foreign exchange shall be delivered by you in free and unrestricted funds, and in the manner indicated on the reverse side hereof. If delivery is to be made by a MAIL or CABLE TRANSFER, delivery shall be made to such one of our foreign Branches or Correspondents, for credit to our account, as shall have been specified to you by us and confirmed in writing; if by a CABLE TRANSFER, such delivery shall be made not later than the due date specified on the reverse side hereof; if by a MAIL TRANSFER, by delivery to us not later than the date specified on the reverse side hereof of a copy of your order instructing the transfer, and delivery must be effected pursuant thereto in due course; if by a CHECK or DRAFT, by delivery to us not later than the date specified on the reverse side hereof of such an item payable in a country where the foreign exchange is the usual medium of exchange and it must be accepted or paid (as the case may be) on presentation.

III. In event of any of the conditions set forth in "II" hereof not being fulfilled, you will, upon demand at any time thereafter, pay us: (a) any United States Dollar amount which we may have paid you on account of the foreign exchange, together with interest thereon at such rate as we may determine to be effective at the time in the aforesaid country for loans or advances to us of the foreign currency, and for the period between the time when such payment was made by us to you and the date when such reimbursement shall have been received by us from you; and (b) any excess of the United States Dollar equivalent of the amount of the foreign exchange (at our selling rate for cable transfer of such foreign exchange on the date of reimbursement) over the purchase price. Should the foreign exchange for which we shall have been thus reimbursed, and/or any relative documents (or the proceeds thereof), be at the time of such reimbursement or thereafter in the possession of our Branch, Correspondent or otherwise under our control, the same will be held for your account without responsibility therefor on the part of this Bank or its Correspondent.

IV. As security for the prompt payment of any indebtedness or liability for which you may be or become obligated hereunder, we shall have a lien upon any and all of your funds and/or other property which is (are) now or may at any time (1) hereafter come into our possession or under our control.

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December 20, 1967

Amsterdam Overseas Corporation  
70 Pine Street  
New York, New York

Attention: Mr. Loaser

Dear Sirs:

Enclosed is the original of our agreement of December 29, 1966 with First National City Bank which we hereby sell to you today for \$187,000. This sale is on the understanding that you will fulfill the obligation to deliver Sterling 1.1 million to First National City Bank on January 3, 1968 without recourse to us.

Yours very truly,

INTERNATIONAL FLAVORS & FRAGRANCES INC.

*H. G. Reid*

H. G. Reid  
Vice President, Finance

Enclosed  
Encl.

ACCEPTED:

*INTERNATIONAL FLAVORS & FRAGRANCES INC.*

By \_\_\_\_\_

7748-70

December 10, 1967

First National City Bank  
399 Park Avenue  
New York, New York 10022

Attention: Mr. E. A. Reichers

Dear Sirs:

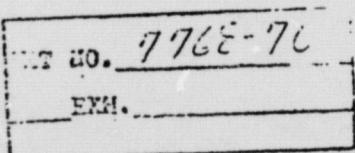
This is to advise you that we have today sold to Amsterdam Overseas Corporation, 70 Pine Street, New York, New York, our contract providing for delivery to you on January 3, 1968 of Sterling 1,100,000 at the rate of U.S. \$2.7691.

Yours very truly,

INTERNATIONAL FLAVORS & FRAGRANCES INC.

*[Signature]*  
H. G. Reid  
Vice President, Finance

HGR:mm



December 20, 1967

First National City Bank of New York  
55 Wall Street  
New York City, N.Y.

Attn: Mr. Edwin A. Reichers

Gentlemen:

This is to inform you that we have this day bought from International Flavors and Fragrances, Inc. their contract with you dated December 29, 1953 calling for the delivery to you on January 3, 1963 of 5 st. 1,100,000 at the rate of \$2.7691 per pound - amounting to \$3,046,010.- to be paid by you on that date. We confirm to you herewith that we agree to take over liability under the said contract provided that you confirm to us that said amount of \$3,046,010 will be paid to us upon delivery of the pound sterling on Jan. 3, 1963.

We understand that International Flavors and Fragrances has given you instruction to have the said contract transferred to us and we are awaiting your confirmation.

Thanking you, we remain

Very truly yours,

AMSTERDAM OVERSEAS CORPORATION

PJL:bm

By Hand

DKT NO.	7768-70
EEB.	

FIRST NATIONAL CITY BANK 14

399 PARK AVENUE, NEW YORK 22, N.Y.

IN REPLY PLEASE QUOTE

FEK

December 20, 1967

A.O. B.C. D.E. E.F. G.H. I.J. K.L. N.F.C.

Amsterdam Overseas Corporation  
70 Pine Street  
New York, N.Y. 10005

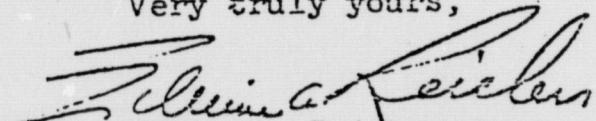
Gentlemen:

In reply to your letter of December 20, 1967, this is to confirm that we have agreed to your purchase from International Flavors and Fragrances Inc. their contract with us wherein they have sold to us on December 29, 1966 Pounds Sterling 1,100,000-0-0 for delivery on January 3, 1968 at the rate of \$2.7691 per Pound. We also wish to confirm that we shall credit your Dollar Account with us on January 3, 1968 the dollar difference between our original purchase price of \$2.7691 per Pound and the rate of exchange applied to your purchase from us of Pounds Sterling 1,100,000-0-0 to close this contract out.

We have also received a letter from International Flavors and Fragrances Inc. confirming their sale of this contract to you.

Awaiting your further instructions in connection with closing out this contract.

Very truly yours,

  
Edwin A. Reichers  
Senior Vice President

EXP NO. 755870

64 Flavors for 1968 at 2.50/10  
64 Flavors for 1968 at 2.50/10

## FIRST NATIONAL CITY BANK

333 PARK AVENUE NEW YORK, N.Y. 10017

15

CONTRACT No. S 1273

IN REPLY PLEASE REFER TO  
ABOVE CONTRACT NUMBERDATE December 20, 1967

Amsterdam Overseas Corporation  
70 Pine Street  
New York, N.Y. 10005

E2123

WE CONFIRM HAVING TODAY SOLD TO YOU THE FOREIGN EXCHANGE DESCRIBED  
HEREUNDER, SUBJECT TO THE CONDITIONS SET FORTH ON THE REVERSE SIDE HEREOF.

AMOUNT	<u>£1,100,000-0-0</u>	TENOR	<u>Cable London</u>
DELIVERY	<u>January 3, 1968</u>	RATE	<u>2.4080</u>

BROKER (IF ANY) \_\_\_\_\_

KINDLY CONFIRM THE ABOVE ON THE COPY HEREOF AND RETURN IT TO US.

CONFIRMED

FIRST NATIONAL CITY BANK

  
AUTHORIZED SIGNATURE

1515 (U 4 PARTS REV. 5-67

DATE 20. 12/20/67  
EXCH. \_\_\_\_\_

1515 (U 4 PARTS REV. 5-67

I. Should the New York market price of the Foreign Exchange decline at any time(s) from the rate you are to pay us therefor, you shall, upon demand by us at any time(s), promptly deposit with us at this office, as security for your obligation, cash or its equivalent in an amount sufficient to cover the amount(s) of the decline(s). In default thereof we may, at our option at any time thereafter, cancel the sale, whereupon you will be indebted to us for, and will pay us upon demand, an amount equal to the difference between the said market price of such foreign exchange as of the date of cancellation and the sale price computed at the rate now in effect as set forth on the reverse side hereof.

II. If any FOREIGN CURRENCY CHECK is issued by us relative hereto, the check may be drawn by us on any of our branches or correspondents, and the drawee is herein referred to as the Payer. We may credit the Payer at any time with the amount of the check (or its equivalent) and, following any such credit, we may regard the amount so credited as being held by us in all respects for the account of the Payer and as subject to its order and control, and we shall be without liability for (a) any acts or failures to act on the part of the Payer, or (b) failure of the funds to reach the payee of the check. The check shall be presented promptly to the Payer for payment and, if drawn in a currency other than that of the place of payment as indicated thereon, it shall be payable to the holder thereof at the then buying rate of the Payer for checks of that currency on the date when payment is effected unless the holder thereof arranges otherwise with the Payer and pays all its charges in connection therewith. Should the check not be paid by the Payer and a refund be desired by the holder, the original of the check duly endorsed and each counterpart thereof which may be outstanding shall be surrendered to us, whereupon as and when the Payer shall have made freely available to us the amount which may have been credited to it relative to the check, we will, subject to any official regulations then applicable thereto, refund the amount of the check to the holder; provided, however, that it shall be optional with us as to whether refund will be made (i) in United States Dollars at our buying rate for the amount of foreign currency on the date of refund, or (ii) in the amount and currency of the check, or (iii) by instructing the Payer to hold the said amount of foreign currency for the holder's account and risk.

III. If a TRANSFER BY MAIL OR CABLE is made by us relative hereto, we may address the transfer to any one of our branches or correspondents, and the one to which it is addressed is herein referred to as the Payer. We may send any message(s) relative to the transfer in explicit language, code or cipher and shall not be liable for errors, delays or defaults in the transmission of any such message(s) by telegraph, cable, wireless, radio, telephone or any other means of transmission, or for any total or partial suspension of any such means of transmission. We may credit the Payer at any time with the amount to be transferred (or its equivalent) and, following any such credit, we may regard the amount so credited as being held by us in all respects for the account of the Payer and as subject to its order and control, and we shall be without liability for any (a) acts or failures to act (inclusive of any failure to identify the Beneficiary) on the part of the Payer, or (b) failure of the funds to reach the Beneficiary. If the transfer is of currency other than that of the country to which it is to be transferred, it shall be payable to the Beneficiary in the currency of the said country at the then buying rate of the Payer for the currency transferred, unless the Beneficiary arranges otherwise with the Payer and pays its charges in connection therewith. In event no payment of the amount to be transferred shall have been made by the Payer and you shall have requested a refund, we will endeavor to notify the Payer to cancel the transaction and, upon the receipt by us of confirmation by the Payer of such cancellation and when the Payer shall have made freely available to us the amount which may have been credited to it relative to the transfer, we will, subject to any official regulations then applicable thereto, refund the amount of the transfer to you, less our expenses and those of the Payer; provided that, if the amount to be transferred is other than U. S. Dollars, it shall be optional with us as to whether refund will be made (i) in United States Dollars at our buying rate for the amount of foreign currency on the date of refund, or (ii) in the amount and currency of the transfer, or (iii) by instructing the Payer, or some other branch or correspondent in the country to which the transfer was sent, to hold the said amount of foreign currency for your account and risk.

IV. If circumstances beyond our control should prevent delivery hereunder of all or any part of the Foreign Exchange within the time specified for the delivery thereof, the time of delivery shall be automatically extended three months and, if such circumstances shall at the end of that period continue to exist, the foreign exchange not theretofore delivered hereunder may, at our option, be purchased by us from you at our then buying rate for cable transfers of such foreign exchange and the accounts between us shall thereupon be adjusted accordingly.

V. As security for the prompt payment of any indebtedness or liability for which you may be or become obligated relative hereto, we shall have a lien upon any and all of your funds and/or other property which is (are) now or may at any time(s) hereafter come into our possession or under our control.

AMSTERDAM OVERSEAS CORPORATION

70 PINE STREET  
NEW YORK, N.Y. 10005

DIGBY 4-4110

17

International Flavors & Fragrances Inc  
521 West 57th Street  
New York, N.Y. 10019

DATE: Dec. 21, 1967

DEAR SIRS:

WE ENCLOSE HEREWITH OUR CHECK  
 PLEASE CHARGE OUR ACCOUNT

IN THE AMOUNT OF

Three Hundred eighty-seven thousand and 00/100 dollars

( \$ 387,000.00 )

MAIL

ADVICE, TO THE ACCOUNT OF

WHICH KINDLY CREDIT, UNDER  CABLE  
 IN PAYMENT OF purchase price for pound sterling contract bought  
from you on December 20, 1967.

YOURS VERY TRULY,  
AMSTERDAM OVERSEAS CORPORATION

REC'D. 7768-70

EX-2

## MEMORANDUM

NEW YORK

18

Mr. Louis Davids

Dept

Herbert G. Reid

Dept

Sale of Sterling Contract

\$387

Ref

Date Dec. 26, 1967

Enclosed is a check for \$387,000 re: sale to Amsterdam Overseas Corporation of our Sterling Contract on December 20, 1967.

~~Enclosed~~ The amount of this sale is subject to tax at the capital gains rate. This should be borne in mind by Tom Havard when calculating the year end tax provisions and preparing the 1967 Federal and State tax returns.

*Herb*

Herbert G. Reid,  
Vice-President Finance

HGR:lde

CC: Tom Havard

Enclosure

20. 11768-70  
FHL

11 Dec  
1944

1. C. C. DEPARTMENT OF EDUCATION  
Name of Militia

### STATEMENT OF FINANCIAL POSITION

Diff = Prior Year

EVANS, J. READING  
Curator

14. PRESENTED 1981  
Date = Current Year

Mr. George Deakin

19

%	Amount	Account Number	Shareholders' Equity	%	Amount	Rate	DEQUIVALENTS	JOURNAL ENTRIES IN P	FINAL P. AMOUNTS
	250,000	2901/09	Capital Stock Issued and Outstanding		250,000		708,400		708,400
	651,593	2920	Capital in Excess of Par Value		62,034		1,125,295		1,195,963
100.0	903,593	2930/90	Retained Earnings	100.0	101,034		2,933,695		3,704,363
			Total Shareholders' Equity			2.80			
			Current Assets				6135	③ + 3,411	9,546
	17,103	1100	Cash in Banks and On Hand		3191		25,634		25,634
	100,000	1110	Marketable Securities		9155		915,401		915,401
	12,476	01201	Notes Receivable - Trade		326929		(33,070)		(33,070)
	312,303	01210	Accounts Receivable - Trade		(11,817)		226,044		226,044
	1,9551	01219	Allowances for Bad Debts		80,901		1,302		1,302
	1,1493	01220	Accounts Receivable - Affiliates		468		69,622		69,622
	914	01260	Accounts Receivable - Employees		34,661		1,243		1,243
	12,811	01270	Accounts Receivable - Other		444		1,463,557		1,463,557
	186	1200	Accounts Receivable - Drawbacks				51,233		54,233
		1290	Accrued Interest Receivable						
		1300	Inventories		522,699				
		1400	Prepaid Expenses and Deferred Charges		19,269				
			Total Current Assets		9634		2,730,081		2,733,472
			Current Liabilities						
		2011	Notes Payable - Bank/Bank Overdrafts						
		2012/13	Notes Payable - Trade & Other						
		2020	Accounts Payable - Trade		51,992		145,578		145,578
		2030/2210	Accounts Payable - Affiliates		16,141		196,116		196,116
		2040	Taxes Withheld from Employees		5804		16,237		16,237
		2070	Dividends Payable						
		2100	Other Accounts Payable and Accrued Expenses		35,099		98,217	① + 12,332	127,609
		2190	Accrued Taxes on Income		39,217		819,370		819,370
			Total Current Liabilities		1430		1,272,219		1,404,962
			Net Current Assets		5144		1,157,862		1,328,530
			Other Assets						
		1500	Investments in Affiliates						
		1550	Advances to Affiliates - Long Term						
		1601/10	Other Assets						
		1603	Loans to Employees - Long Term		38561		71,570		71,570
			Fixed Assets		782,278		2,106,320		2,106,320
			Accumulated Depreciation and Amortization		(248,234)		(695,325)		(695,325)
		1900	Intangible Assets, Less Amortization						
			Total Net Current Assets and Other Assets		101,77		2,940,417		3,811,085
			Long Term Liabilities						
		2310/60	Notes Payable - Bank Loans and Mortgages						
		2330/50	Reserves for Retirement Benefits and Pensions		4604		12900		12,900
		2370	Deferred Taxes on Income		33508		93,822		93,822
		2300	Advances from Affiliates - Long Term						
		2390	Other Long Term Liabilities						
			Total Long Term Liabilities		377		106,722		106,722
			Excess of Assets Over Liabilities		100.0		2,833,695		2,704,363

20 JAN. 1964

L. F. LIGGETT, SECRETARY  
Name of Affiliate

Prince Stearns  
Currier

I.F.F.-Great Britain

STATEMENT OF INCOME AND RETAINED EARNINGS  
FOR THE 12 MONTHS ENDED 31 December 46

20

1465  
PUBL. YAN

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### Dividends Declared

## Exchanges from a (loss) in connection

2930/90 Retained Earnings, 31 DECEMBER  
End of Period Date

2 JAN 1967  
Date Received

\* 21518 12/30/65 C.0450200000000000

Mr. C. J. Ragetlie

IFF-Hilversum

H. G. Reid

IFF-New York

21

December 22, 1966

Sterling Protection

77 Dear Kees:

67 Today Lou Davids and I have had a long discussion re: the above-indicated matter  
11 and have studied intensely your letters of November 22 and December 5 which dealt  
11 with this subject. While both of us feel your position is correct insofar as the  
11 ultimate economic reality is concerned, we nevertheless believe that there is a  
11 practical problem of balancing possible foreign exchange losses on devaluation of  
11 sterling with hedging profits. If you look at the problem this way, and frankly  
05 we are concerned with not reporting substantial foreign exchange losses if ster-  
ling goes, it is necessary to hedge against the entire amount of the exposed net  
current assets since these will have to be written down in terms of dollars if  
there is a unilateral devaluation of the U.K. currency. Accordingly, we recom-  
mend that the amount of the hedging transaction be sufficient to equal, on an  
after-tax basis, the amount of the exposed net current assets in England. Spe-  
cifically, if we purchase in Holland a contract to supply the sterling equivalent  
of U.S.\$3,000,000 one year from now, the after-tax protection will be 53% of this  
amount or approximately \$1,600,000 which gives us reasonable protection of the  
approximately \$1,500,000 of exposed net current assets of IFF-U.K. Basing myself  
on a quotation I received from First National City Bank today, the difference  
between spot and one-year sterling is the equivalent of 3/4 of 1% and, assuming  
this differential will prevail at the date we would have to cover, the contem-  
plated transaction would cost us around U.S.\$22,500 or U.S.\$12,000 after taxes.  
77 I believe that the protection to be gained makes this relatively small expense  
68 very worthwhile.

63 If you are in agreement with the proposal I have set forth above, you can consider  
this as an authorization to proceed with this transaction. I believe the amount  
in question should also be sufficient to protect the exposed sterling assets of  
IFF-Nederland.

60 I am not at all sure that the Dutch company or even IFF-Europe should be required  
63 to foot the bill, whatever it ultimately turns out to be for this hedging trans-  
action, since it is really done for corporate financial rather than for operating  
purposes. Since we presumably will not have to pay anything until the expiration  
of the future's contract, we will have plenty of time to discuss where the ulti-  
mate expense should be recorded. Of course, if there is a devaluation, the gain  
would have to be included with the European operations to match the loss in the  
U.K.

Mr. C. J. Ragetlie

-2-

December 22, 1966

22

If any of the above is not clear to you or you believe this matter requires further discussion, I suggest you telephone me at your earliest convenience. In addition, if the Amsterdam rate for such a transaction is substantially different than the 3/4 of 1% indicated above, we might give consideration to affecting the transaction through New York. We should also consider whether we should cover for two years instead of one. First National City Bank in New York advises that this may be possible for a per annum cost of .85%.

Best regards,

H. G. Reid

HGR:pp

cc: Mr. R. D. Peachey  
Mr. L. Davids

1 UNITED STATES TAX COURT

23

2  
3 INTERNATIONAL FLAVORS AND FRAGRANCES, INC.,

4 Petitioner

Docket Number

5 COMMISSIONER OF INTERNAL REVENUE,

7768-70

6 Respondent.

7  
8  
9 United States Tax Court  
10 Room 206 Federal Office Bldg.  
11 26 Federal Plaza  
12 New York, New York

13 Monday 30 April 1973

14 Met, pursuant to notice, at 11:30 a.m.

15 BEFORE:

16 WILLIAM H. QUEALY, JUDGE

17 APPEARANCES:

18 GEORGE ROWE, JR., ESQ.,

19 On behalf of the Petitioner;

20 MARION L. WESTEN, ESQ.,

21 On behalf of the Respondent;

22 WARREN W. DILL, ESQ.,

23 On behalf of the Respondent.

1      C O N T E N T S2      EXHIBITS

3	<u>JOINT</u>	<u>IDENT.</u>	<u>EVID.</u>
4	1A through 13N	3	3
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1           THE CLERK: Docket Number 7768-70, International  
2           Flavors and Fragrances, Inc. May we have the appearances,  
3           please?

4           MR. ROWE: Your Honor, my name is George Rowe, Jr. of  
5           the firm of Fulton, Walton and Duncombe in New York City and  
6           I appear for the Petitioner.

7           MS. WESTEN: Marion L. Westen.

8           MR. DILL: Warren W. Dill.

9           MS. WESTEN: For the Respondent.

10          THE COURT: All right. The parties have a Stipula-  
11          tion?

12          MS. WESTEN: Yes, we have an original and one copy of  
13          a proposed Stipulation of Facts. Exhibit 12L, Your Honor, is  
14          an inter-office memorandum and we expressly do not stipulate  
15          to the legal conclusions contained therein.

16          THE COURT: Stipulation will be received and made a  
17          part of the record. Exhibit numbers are --

18          MS. WESTEN: Exhibits 1A through 13N.

19          THE COURT: Exhibits 1A through 13N.

20           (Whereupon, the aforementioned documents  
21           were marked as Joint Exhibits Numbers 1A  
22           through 13N for the purpose of identifica-  
23           tion and received into evidence.)

24          THE COURT: Do the parties wish to make an opening  
25          statement?

1                   MR. ROWE: Yes, Your Honor. As I've stated, I  
2 represent International Flavors and Fragrances, Incorporated,  
3 a New York Corporation, the Petitioner here and sometimes we  
4 will refer to that corporation as IFF. IFF is a manufacturer  
5 of flavor and fragrance products which are used by other  
6 manufacturers to impart aroma or flavor to their product.  
7 IFF's facilities are located in the United States. It owns  
8 the stock of other companies throughout the world which do a  
9 like business in their respective territories. IFF publishes  
10 to its shareholders only consolidated financial statements,  
11 that is, the balance sheets of the various subsidiaries and  
12 their income statements are all combined with those of the  
13 parent company, IFF, into a single balance sheet and a single  
14 income statement which is always expressed in United States  
15 dollars. There are no published individual statements. In  
16 other words, IFF's investments in or interests in its  
17 subsidiaries are reflected and reported by the use of  
18 consolidated financial statements.

19                   At issue in this case is the proper tax upon a gain  
20 realized by the Petitioner in a transaction which took place  
21 in the year 1967 and the amount of tax in controversy is  
22 approximately \$74,000.00. The circumstances giving rise to  
23 that transaction are as follows: As I stated, IFF has  
24 investments in subsidiaries which own facilities and do  
25 business abroad. One such subsidiary is IFF Great Britain,

1 Limited, English Company. In late 1966, IFF officials were  
2 concerned that the pound would be devalued. The effect of  
3 devaluation would be to adversely affect IFF's investments in  
4 its British subsidiary as reflected and reported in the  
5 consolidated statements to which I refer. This would  
6 naturally occur because figures previously translated at the  
7 old rate would now need to be translated at the new lower  
8 rate. Obviously, the dollar figures would be lower than if  
9 the old rate remained in effect. To offset this possible  
10 adverse effect, IFF, on December 29, 1966, entered into a  
11 contract with First National City Bank. Pursuant to that  
12 contract, IFF sold to that bank, one million one hundred  
13 thousand British pounds, delivery to be made on January 3,  
14 1968 which was approximately 15 months later. The bank  
15 agreed to pay for those pounds upon delivery, \$2.7691 per  
16 pound. On December 29, 1966, the rate of exchange was  
17 2.7918 per pound spread between those two, amounted to  
18 approximately \$34,000.00. That is, at the time the contract  
19 was entered into, December 29, 1966, the spread was  
20 approximately \$34,000.00. The pound was, in fact, devalued  
21 November 17, 1967. The official rate went from \$2.80 per  
22 pound to \$2.40 per pound. Shortly thereafter, in December of  
23 that year, IFF, instead of waiting and closing its transaction  
24 with City Bank, sold its contract with City Bank to  
25 Amsterdam Overseas Corporation. At that time, the difference

1 between the current rate at which pounds could be bought and  
2 the price to be paid by First National City Bank upon  
3 delivery of the one million one hundred thousand pounds on  
4 January 3, 1968, was approximately \$397,000.00. In other  
5 words, IFF, at that time, had a potential profit of that  
6 amount on the contract. Amsterdam paid IFF for the contract  
7 exactly \$387,000.00 or approximately \$10,000.00 less than the  
8 potential profit on the contract on that date. On that date,  
9 of course, that profit could have shrunk or increased  
10 depending upon further changes in the rates of exchange.

11 IFF sold the contract for good business reasons  
12 including tax reasons. We say that capital gains rates are  
13 applicable because the contract was a capital asset within  
14 the meaning of Section 1221 of the Code. We say that  
15 Petitioner held it for over six months and Petitioner sold it  
16 without recourse thereafter. We say, under those circumstances  
17 the law is that we're entitled to capital gains treatment of  
18 the transaction.

19 THE COURT: Ms. Westen?

20 MS. WESTEN: Mr. Dill is going to make the opening  
21 statement, Your Honor.

22 MR. DILL: Your Honor, the deficiency in this case  
23 is in income tax for the taxable year 1967. The issue before  
24 the Court today is whether the transfer of an agreement  
25 which provided for the future delivery by International

1 Flavors and Fragrances, at a specified exchange rate of  
2 British pound sterling is a long-term capital gain in the  
3 amount of \$387,000.00 as reported by IFF or a short-term  
4 capital gain on the short sale of the pounds themselves as  
5 contended by Respondent. Alternatively, Respondent contends  
6 it was a hedging transaction taxable at ordinary income rates.

7 The essence of the transaction is as follows: On  
8 December 29, 1966, First National City Bank agreed to purchase  
9 from IFF one million one hundred thousand British pound  
10 sterling at the exchange rate of \$2.7691 per pound, delivery  
11 to be on January 3rd, 1968. On November 17, 1967, devaluation  
12 The British pound sterling was devalued \$2.4080. On December  
13 20, 1967, approximately one month after the devaluation of  
14 the pound and just two short weeks before the January 3rd  
15 date specified in the agreement for the delivery of the  
16 pounds, IFF transferred its agreement with First National  
17 City Bank to Amsterdam Overseas Corporation for \$387,000.00.  
18 Amsterdam was to fulfill IFF's obligation to deliver the  
19 one million one hundred thousand British pound sterling to  
20 First National City Bank.

21 Now, the Petitioner would have us agree that he may  
22 turn what would be a short-term capital gain into a long-term  
23 capital gain by simply transferring this agreement to a third  
24 party prior to its maturity date. To agree with such a  
25 theory would be to completely ignore the Congressional purpose

1 for enactment of Section 117, the forerunner of Section 1233.  
2 The Legislative intent behind Section 1233 was to close a  
3 loophole whereby taxpayers manipulated the holding period for  
4 property in connection with short sales. In view of this, it  
5 would be inconsistent with Code Section 1233 to hold that a  
6 taxpayer could convert what would be a short-term capital  
7 gain at a time when each short sale contract matured, into a  
8 long-term capital gain at some earlier date.

9 To support the position taken by Petitioner would be  
10 to extract the very backbone from Section 1233 and to write it  
11 out of the Code.

12 The issue presented here today and embraced by a  
13 unique set of facts, is somewhat novel to the Court but not so  
14 to the astute tax planner who is constantly challenging  
15 provisions of the Internal Revenue Code in that his only  
16 concern is to comply with the letter of the law while  
17 disregarding the spirit of the law.

18 THE COURT: Thank you. Call your first witness,  
19 please.

20 MR. ROWE: Your Honor, would this be the appropriate  
21 time to respond to a subpoena? Mrs. Westen suggested that I  
22 do it after the opening statement.

23 MS. WESTEN: I can submit the original subpoena to  
24 the Court at this time as to the materials that were  
25 subpoenaed.

1 THE COURT: Now, is there any problem with this  
2 subpoena?

3 MR. ROWE: No, I don't think so but I'd like to  
4 respond to it.

5 THE COURT: I don't think we can get into the question,  
6 Counsel. You're just going to physically respond to it, is  
7 that it?

8 MR. ROWE: What question is that?

9 THE COURT: As to how much of this might be relevant.

10 MR. ROWE: Oh, no, that's not at issue. I just  
11 would like to say on item one, the minute books that are here,  
12 I produced the minute books for 1966, '67 and '68.

13 THE COURT: Let me ask -- Ms. Westen, is the Govern-  
14 ment's position based on the contention that these people  
15 were traders in currency?

16 MS. WESTEN: No, Your Honor. The Government's  
17 position is based alternatively upon the position that this  
18 transaction represents a short sale or alternatively that it  
19 is in the nature of a hedging transaction. If I can give  
20 Your Honor a little background, at page 10 of Exhibit 2B,  
21 reflects that during 1967, British International Flavors and  
22 Fragrances engaged in the following transactions with the  
23 Petitioner and it says one and a quarter million dollars just  
24 during that year. Sales of stock in trade to the Petitioner  
25 having a value of \$540.00, purchases of stock in trade from

1 the Petitioner having a value of \$885,173.00, payment of  
2 compensation to the Petitioner for addition of technical  
3 know-how and like services in the amount of \$374,188.00. In  
4 addition to the direct transaction between the Petitioner and  
5 British IFF, page 10 of Exhibit 2B discloses the following  
6 transaction aggregating in excess of \$500,000.00 for 1967  
7 between British IFF and a corporation or corporations  
8 controlled by the Petitioner. Commissions received by British  
9 IFF from the controlled corporation in the amount of  
10 \$1480.00, payment of compensation for technical know-how and  
11 like services from IFF to the controlled company in the amount  
12 of \$59,508.00, payment of commissions in the amount of  
13 \$22,903.00 by British IFF to corporations controlled by --

14 THE COURT: Let me interrupt you, Ms. Westen. If  
15 they're paying them in dollars to British IFF --

16 MS. WESTEN: Well --

17 MR. ROWE: That's why we would like to respond to the  
18 subpoena.

19 MS. WESTEN: Well, this is part of the question,  
20 Your Honor.

21 THE COURT: But this is all a matter you can argue  
22 in the brief. Before Brett and Woods, almost all the  
23 companies were doing this and I assume probably a lot of them  
24 were doing it through foreign subsidiaries now.

25 MS. WESTEN: Well, it's our position, Your Honor,

1 that where you have transactions in the pound sterling area  
2 of almost two million dollars, this would not include any  
3 transaction -- this does not include any transactions in the  
4 pound sterling area for the year between the Petitioner and  
5 unrelated third parties that -- in essence, what you've got  
6 is an item of inventory which is as much an item of inventory  
7 as any other item of stock in trade which the Petitioner might  
8 have.

9 THE COURT: Wasn't that argued a long time ago when  
10 National Cash Register and the first of the so-called  
11 internationals used to do this as a regular course every time  
12 they made a sale and the profit at home? I believe the  
13 Government won on that case.

14 MS. WESTEN: The point, Your Honor, is not how it  
15 was argued but the evidence should be in the record to form a  
16 basis for argument.

17 THE COURT: You're free to put any evidence you'd like.  
18 I would think the parties could stipulate as to what the pound  
19 transactions were between these taxpayers.

20 MR. ROWE: Your Honor, may I address myself to that.  
21 We have done exactly that. IFF is a U.S. company. It doesn't  
22 bill in foreign currencies, it bills in dollars. She's  
23 trying to make the point that this is a hedging transaction  
24 but how can you hedge against dollars when you have dollars?  
25 You'd have to have pounds.

1 THE COURT: I have no difficulty finding this is a  
2 hedging transaction because I happen to know that before  
3 Brett and Wood that practically all American Companies doing  
4 business abroad hedged in just this manner. They didn't have  
5 their foreign subsidiaries do the hedging. They had to do  
6 the hedging.

7 MS. WESTEN: Well, the point is that when you're  
8 doing the hedging and when you're going to be affected by a  
9 fluctuation in the value of the currency, the hedging item  
10 represents an ordinary asset and it's not a capital asset so  
11 that even if you assumed the sale of the contract, it is the  
12 Government's position that this would generate ordinary  
13 income.

14 THE COURT: Well, it's my recollection that dependent  
15 on whether or not you matched your hedging with your foreign  
16 transactions --

17 MS. WESTEN: Which, Your Honor, is part of the reason  
18 why we subpoenaed these records.

19 THE COURT: Well, I would assume that you would have  
20 known that before you issued the notice of deficiency, Ms.  
21 Westen. Now, you've got the records, what are you going to  
22 do with them?

23 MR. ROWE: Well, Your Honor, may I say this? This  
24 company was audited, of course, in 1966 and all the records  
25 were made available at that time. Likewise, the agent came

1 up the other day and we made available to him all of our  
2 records. We haven't brought every book and record of  
3 International Flavors and Fragrances down here. We'd have  
4 to bring down a moving van. Ms. Westen, your agents are free  
5 to look at these at any time but no point would be served by  
6 bringing them in. We did bring in, we had understood from my  
7 conversation with Ms. Westen, what she was after here and that  
8 is a record of the transactions in pounds in which this  
9 Petitioner engaged in.

10 MS. WESTEN: I wasn't after records for transactions  
11 in pounds. My subpoena expressly reads, the original books  
12 and records of account relating to the Petitioner's  
13 transactions in the pound sterling area during the years 1966,  
14 1967 and 1968 which resulted in obligations due to or payable  
15 by the Petitioner.

16 THE COURT: What do you mean in the pound sterling  
17 area?

18 MS. WESTEN: I mean an area in company with business  
19 entities to whom or for whom the national currency is the  
20 British pound sterling. And therefore with reference to  
21 which the prices would be determined, whether they're billable  
22 in dollars or whether they're billable in pounds.

23 MR. ROWE: You can ask my witness. He'll know those  
24 answers. But, in any case, Your Honor, I must say that when  
25 I got this, I had a little trouble with that language too.

1 The same language was used in a letter earlier requesting  
2 information. We have no objection to having all these records  
3 opened to her. Her agent has had --

4 THE COURT: Well, why don't you send an agent out and  
5 have him get the information you want, Ms. Westen?

6 MS. WESTEN: My agent wasn't shown the accounts  
7 receivable ledgers and --

8 THE COURT: Counsel has said here in open Court that  
9 he's perfectly willing to let the agent get any information  
10 he wants. We can't sit here and start pulling teeth.

11 Why not --

12 MS. WESTEN: Because we're entitled to have the  
13 original evidence in the Court Room.

14 THE COURT: Well, we have a ruling with regard to the  
15 Stipulation, Ms. Westen. Now, we'll receive what the parties  
16 have presented so far and the case will be continued to  
17 permit the Government to send the agent out and examine these  
18 records and determine what can be stipulated and what can't.

19 MR. ROWE: Do you really want to do that?

20 MS. WESTEN: Yes.

21 THE COURT: Let her do it. I've found that it's much  
22 easier to agree with ladies than to try and change their  
23 minds.

24 MR. ROWE: When would you like us to return, Your  
25 Honor?

1 THE COURT: Well, I don't know. You can advise us  
2 some future date when Ms. Westen is satisfied. So the case  
3 will be continued. I'll keep jurisdiction since you've put  
4 in all of this. I come up here regularly so case will be  
5 continued and it's the Court's understanding that Mr. Rowe  
6 will cooperate and make the information available to the agent  
7 to assemble the type of statistical data that Ms. Westen is  
8 interested in.

9 MR. ROWE: We've already done that, Your Honor.

10 THE COURT: Well, if you have --

11 MR. ROWE: It was done on two different occasions.

12 THE COURT: Well, let her submit a stipulation to you  
13 but I'm not going to sit here and go through the records,  
14 Ms. Westen. You know the rules of our Court as well as  
15 anybody.

16 MR. ROWE: Would it be possible to proceed and then  
17 continue the balance --

18 THE COURT: Well, what is there to proceed on other  
19 than that, Counsel? You don't have any more stipulations.

20 MR. ROWE: Well, we have one witness here who would  
21 like to explain why we did --

22 THE COURT: I think maybe before we hear the witness,  
23 Counsel for the Respondent is going to have to be prepared  
24 with the information she'll need to ask the witness questions.  
25 That's the only problem I see. There's no use in calling him

1 twice.

2 MS. WESTEN: I would assume, Your Honor, that if it's  
3 documentary evidence which we're going to have set out in  
4 schedule form, there would be no objection as far as the  
5 Respondent is concerned in permitting the witness to testify.

6 THE COURT: All right, but you're not going to want  
7 to recall him then after you get these records?

8 MS. WESTEN: Well, that can't be determined --

9 THE COURT: Then we'll wait until after you determine.  
10 So, we'll continue this case until the parties are ready for  
11 trial.

12 MR. ROWE: I'm ready, Your Honor.

13 THE COURT: We'll recess until 1:00 o'clock.

14 (Whereupon, the case was closed.)

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## 1 UNITED STATES TAX COURT

2 - - - - -  
3 INTERNATIONAL FLAVORS AND FRAGRANCES, INC.

Docket Number

4 Petitioner

7768-70

5 COMMISSIONER OF INTERNAL REVENUE,

6 Respondent.  
7 - - - - -8 Room 206 Federal Building  
9 26 Federal Plaza  
New York, New York

10 July 19, 1973

11 Met, pursuant to notice, at 10:00 a.m.

12 BEFORE:

13 WILLIAM H. QUEALEY, JUDGE

14 APPEARANCES:

15 GEORGE ROWE, JR., ESQ.

16 On behalf of the Petitioner

17 MICHAEL J. GAYNOR, ESQ.,

18 On behalf of the Petitioner

19 MARION WESTEN, ESQ.,

20 On behalf of the Respondent

21 WARREN DILL, ESQ.,

22 On behalf of the Respondent

23

24

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1                   C O N T E N T S2                   WITNESSES:                   DIRECT                   CROSS

3                   James Morrison                   4                   37

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6                   EXHIBITS:                   FOR IDENTIFICATION                   IN EVIDENCE

7                   Joint

8                   14-N through 23-W                   3                   3

9

10                  Petitioner's

11                  24 through 26                   9                   9

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1 THE CLERK: Docket Number 7768-70, International  
2 Flavors and Fragrances, Inc. Your appearances, please,  
3 gentlemen?

4 MR. ROWE: My name is George Rowe, Jr. and I'm a  
5 member of the firm of Fulton, Walker and Duncombe and we  
6 represent the Petitioner International Flavors and Fragrances,  
7 Inc. and on my left, Your Honor, is Mr. Michael Gaynor, one of  
8 my associates. He has applied to the Tax Court for permission  
9 to practice before the Tax Court but that's not been acted  
10 upon yet.

11 MS. WESTEN: Marian Westen.

12 MR. DILL: Warren W. Dill for Respondent.

13 MR. ROWE: Your Honor, we have a further stipulation,  
14 a supplemental Stipulation of Facts, Exhibit 14-N, Joint  
15 Exhibit 14-N through 23-W.

16 THE COURT: Be received and made part of the record.  
17 (Whereupon, the aforementioned documents  
18 were marked as Joint Exhibits 14-N through  
19 23-W for the purpose of identification and  
20 received into evidence.)

21 MR. ROWE: Your Honor, there are certain of the  
22 Exhibits here which, unfortunately, are not clearly legible.  
23 As a matter of fact, some of them are very difficult to read.  
24 What I'd like to do is provide more legible copies and submit  
25 them to the Court and I'll work that out with Ms. Westen, if

1 that's agreeable to you.

2 THE COURT: That will be satisfactory.

3 MR. ROWE: In the original Stipulation, on page 2 of  
4 the first Stipulation, there is a reference, in paragraph 3,  
5 to an Exhibit 8-N, it should be 8-H and I note in the  
6 transcript also, there's a reference to -- that's in the  
7 Stipulation, Your Honor, ~~the original Stipulation~~, there's a  
8 typographical error. There is a reference to 8-H and it should  
9 be 8-N and on page 2 of the transcript of the first hearing  
10 on April 30, there is a reference to Joint Exhibits 1A through  
11 13N and my attention is called to the fact that it should be  
12 13M. I only have one witness to call. I'd like to call Mr.  
13 Morrison.

14 JAMES MORRISON

15 a witness herein, called by the Petitioner, having been first  
16 duly sworn, was examined and testified as follows:

17 THE CLERK: Would you state your name and address  
18 for the record, sir?

19 THE WITNESS: James F. Morrison, 25 Strickland Place  
20 Manhasset, New York.

21 DIRECT EXAMINATION

22 BY MR. ROWE:

23 Q Mr. Morrison, are you employed by the Petitioner in  
24 this case, International Flavors and Fragrances, Inc.?

25 A Yes.

1 Q In what capacity?

2 A Comptroller.

3 Q Would you state your duties?

4 A I am responsible for all the accounting operations of  
5 the corporation world-wide.

6 Q Can you state your education and your employment  
7 prior to IFF?

8 A I have a Bachelor's Degree in Economics, a Masters  
9 of Business Administration in Finance and a CPA. I was  
10 Accounting Manager for Freightier Mall Corporation, Division of  
11 Basic Products Corporation, Assistant Vice President and  
12 Assistant Vice President and Assistant Comptroller Northwestern  
13 National Insurance Company, Comptroller of Utechtic Corporation  
14 and just prior to joining IFF, various capacities at Sterling  
15 Drug.

16 Q You were employed by IFF in 19--

17 A '70.

18 Q It's been stipulated, Mr. Morrison, that IFF is  
19 engaged in the creation and manufacture of flavor and  
20 fragrance products used by other manufacturers to impart or  
21 improve flavors or fragrances in a variety of consumer  
22 products. IFF's physical facilities, that is, its  
23 manufacturing facilities, its research facilities and its  
24 offices are located in the United States; is that correct?

25 A Yes.

1 Q Does IFF hold stock in other companies incorporated  
2 in foreign countries which do a like business in those  
3 countries?

4 A Yes, it does.

5 Q Does IFF hold 100 per cent of the stock of such  
6 company which is incorporated in Holland?

7 A Yes.

8 Q What's its name?

9 A International Flavors and Fragrances, IFF Nederland  
10 BV.

11 Q And does that company own 100 per cent of the stock  
12 of an English -- of such a company in England?

13 A Yes, it does.

14 Q What is the name of that company?

15 A International Flavors and Fragrances IFF, Great  
16 Britain, Limited.

17 Q And would you please briefly describe the British  
18 company's physical facilities?

19 A Yes, they have flavor and fragrance compounding  
20 facilities and creative research facilities, administrative  
21 facilities in Enfield, England and their own chemical fragrance  
22 and flavor ingredient manufacturing facilities in Haverhill,  
23 England.

24 Q This company has been in existence for a long time?

25 A Yes.

1           Q     Do you remember approximately when it was  
2 incorporated?

3           A     I think back in the 20s.

4           Q     Most of IFF's sales, that is, the Petitioner's sales  
5 in and around 1966 and 1967, are made to U.S. customers, is  
6 that correct?

7           A     Yes, they are.

8           Q     Coming back to the question of IFF subsidiaries for  
9 a minute, Mr. Morrison, will you please list IFF's foreign  
10 subsidiaries in 1966 and 1967 and you may refer to any notes  
11 that you have.

12           MS. WESTEN: Excuse me, Your Honor, we have all those  
13 2956s in the record and I think they would show all the  
14 subsidiaries that the company had.

15           MR. ROWE: Well, I don't know that. You may go up  
16 and show it to the witness.

17           THE WITNESS: 2952?

18           MS. WESTEN: 2952, right. It's information with  
19 respect to controlled foreign corporations so we've got  
20 something in the record which would indicate those corporations  
21 which are directly or indirectly controlled by the Petitioner  
22 in this case.

23           MR. ROWE: Is that so, Mr. Morrison?

24           THE WITNESS: Could I just take a look at that?

25           MR. ROWE: I'll accept that, Your Honor, without

1 requiring the witness to list them again.

2 BY MR. ROWE:

3 Q Now, Mr. Morrison, does IFF in published financial  
4 statements reflect its investment in or interest in these  
5 various foreign companies?

6 A Yes, it does.

7 Q How does it do so?

8 A It takes the local currency statements, translates  
9 them to dollars and then consolidates the figures world-wide.

10 Q All right, that is, you take the figures from the  
11 various subsidiaries and you consolidate a balance sheet and  
12 consolidate a profit and loss statement?

13 A That's right, in dollars.

14 Q In dollars. Are these financial statements  
15 published regularly to IFF shareholders and the public  
16 generally?

17 A Yes, they are.

18 Q Are individual statements published and made  
19 available?

20 A No, they are not.

21 Q Why does your company only publish consolidated  
22 statements?

23 A Because that's what the shareholders and investing  
24 public are interested in, the consolidated world-wide dollar  
25 figures of the company.

1 MR. ROWE: I ask the reporter to mark as Petitioner's  
2 Exhibits 24, 25 and 26, financial statements for those years,  
3 what are purported to be financial statements for those years  
4 for International Flavors and Fragrances, Inc.

5 MS. WESTEN: Would you like to identify them by year,  
6 Mr. Rowe, for us?

7 MR. ROWE: All right. Exhibit 24 would be 1966 and  
8 I'm only marking the financial statements. Exhibit 25 would  
9 be 1967 and 26 would be '68.

10 THE CLERK: Petitioner's Exhibits 24, 25 and 26 for  
11 identification.

12 (Whereupon, the aforementioned documents  
13 were marked Petitioner's Exhibits 24, 25  
14 and 26 for the purpos of identification.)

15 BY MR. ROWE:

16 Q Mr. Morrison, I show you Exhibits 24, 25 and 26  
17 identified as financial statements, consolidated financial  
18 statements for IFF for those years and ask you, are those the  
19 consolidated financial statements to which you referred?

20 A Yes, they are.

21 MR. ROWE: I offer them in evidence.

22 MS. WESTEN: We've seen them and have no objection.

23 THE COURT: Be received.

24 THE CLERK: Exhibits 24, 25 and 26.

25 (Whereupon, the aforementioned documents,

1 heretofore marked as Petitioner's Exhibits  
2 24, 25 and 26 for the purpose of identifi-  
3 cation, were received into evidence.)

1 BY MR. ROWE:

5 Q Mr. Morrison, was IFF's financial staff concerned,  
6 in and around November, 1966, that the English pound might be  
7 devalued?

8 A Yes, they were.

9 Q And that concern led to IFF's sale to First National  
10 City Bank of 1,100,000 pounds for delivery against payment in  
11 1968: is that correct?

12 A Yes, it did.

13                   MR. DILL: Your Honor, Respondent would like to  
14 object to this particular line of questioning since the record  
15 has established that Mr. Morrison was not with IFF during that  
16 year and has no knowledge of his own as to their concern at  
17 the time.

18 THE COURT: The objection is sustained.

19 BY MR. ROWE:

20 Q Mr. Morrison, have you had occasion to review your  
21 company's records in and around that time, 1966, that is?

22 A Yes, I have.

23 Q And is that the basis for your statement that there  
24 was concern on your company's part that the pound might be  
25 devalued at that time?

1 A Yes.

2 MR. DILL: Your Honor, Respondent objects. We would  
3 like to know if the records he refers to are in the Court Room  
4 today.

5 THE COURT: I think, Mr. Rowe, the records of that  
6 would be the only evidence of concern. I'm not sure that any  
7 of this has relevance to the case.

8 MR. DILL: Your Honor, Mr. Morrison wouldn't be  
9 qualified to identify these records anyway, if he wasn't there.

10 THE COURT: He's custodian of the records now. He's  
11 an officer of the company and qualified for identifying records  
12 if the records are here.

13 MR. ROWE: I ask the reporter to mark --

14 THE COURT: We'll mark the record and we'll mark it  
15 for identification and then when he offers it in evidence, I'll  
16 let you state your objection before I admit it.

17 MR. DILL: Well, I think that --

18 THE COURT: I'm not interested -- I'll decide what  
19 we're going to do later. Just -- we'll proceed here in a  
20 normal fashion and you can make your objections.

21 THE CLERK: Exhibit 27 for identification.

22 (Whereupon, the aforementioned document was  
23 marked as Petitioner's Exhibit Number 27 for  
24 the purpose of identification.)

1 BY MR. ROWE:

2 Q Mr. Morrison, I show you what purports to be a copy  
3 of a letter which seems to have been written from a Mr. Reid  
4 to a Mr. Getley dated December 22, 1966 and ask you if you can  
5 identify that letter.

6 A Yes.

7 Q Did you obtain --

8 MR. DILL: Your Honor --

9 THE COURT: Wait until he qualifies it.

10 BY MR. ROWE:

11 Q Did Mr. Reid keep a correspondence file?

12 A Yes, he did.

13 Q And did you obtain this particular letter from that  
14 file?

15 A Yes, I did.

16 Q And did you make a search of that file to obtain this  
17 letter at my request?

18 A That's correct.

19 Q And these files are within the financial department  
20 of which you are a member.

21 A That is correct.

22 MR. ROWE: Your Honor, I would like to show you the  
23 letter and I would like to offer it in evidence.

24 THE COURT: Who is Mr. Ragoletti?

25 THE WITNESS: He is the European Comptroller of

1 International Flavors and Fragrances.

2 THE COURT: And who is Mr. Reid?

3 THE WITNESS: He is a financial vice president.

4 THE COURT: And who is Mr. Hillems?

5 THE WITNESS: That's the location in Europe.

6 THE COURT: I see. Now, does the Respondent object?

7 MR. DILL: Respondent objects on numerous grounds.

8 THE COURT: Well, let's take them one at a time.

9 What's the first one? I understand you've had it before, Ms.  
10 Westen, so we're not going to play games. What's your first  
11 objection?

12 MR. DILL: Your Honor, Respondent's first objection  
13 is that this letter is pure hearsay.

14 THE COURT: Overruled. What's your next objection?

15 MR. DILL: The second objection is that the letter  
16 is not executed.

17 THE COURT: Overruled. What's your next objection?

18 MR. DILL: Respondent's next objection is that the  
19 letter is a copy, it is not the original.

20 THE COURT: Overruled, what's your next objection?

21 MR. DILL: The next objection is this is a self-  
22 serving statement and contains nothing but opinion on the part  
23 of Petitioner.

24 THE COURT: Overruled, what's your next objection?

25 MR. DILL: And there's no foundation in the record

1 to prove the opinion.

2 THE COURT: Overruled. What's your next objection?

3 MR. DILL: It is completely unrelated to cross  
4 examination here.

5 THE COURT: Let it be admitted.

6 THE CLERK: Exhibit 27.

7 (Whereupon, the aforementioned document,  
8 heretofore marked as Petitioner's Exhibit  
9 Number 27 for the purpose of identifica-  
10 tion, was received into evidence.)

11 BY MR. ROWE:

12 Q Mr. Morrison, was this the basis of your earlier  
13 statement that there was concern among IFF personnel according  
14 to the records of the company that the pound might be devalued  
15 in 1966?

16 A Yes, sir.

17 THE COURT: Let me say this to counsel for both  
18 sides that the fact that they went out and sold the pound  
19 short is a pretty good indication that it might be devalued.

20 MR. ROWE: Yes, Your Honor. I did not anticipate  
21 any difficulty with this line of questioning.

22 THE COURT: That's the only reason you'd do it. As  
23 far as the Court is concerned, I just fail to see what the  
24 problem is.

25

1 BY MR. ROWE:

2 Q Mr. Morrison, Joint Exhibit 4-D shows that on  
3 December 20, 1967, IFF entered into a contract with Amsterdam  
4 Overseas Corporation to sell to that banking institution the  
5 contract between IFF and First National City Bank to deliver  
6 to City Bank in January, 1968, 1,100,000 pounds sterling.  
7 Have you examined or caused to be examined the books and  
8 records of IFF and otherwise inquired to determine whether or  
9 not IFF owned any stock in Amsterdam in or around 1966 and  
10 1967?

11 A Yes, sir.

12 Q What was the result?

13 A They did not own any stock.

14 Q Did you make the same kind of examination to see  
15 whether Amsterdam owned any stock of IFF?

16 A Yes, sir.

17 Q What was the result?

18 A No stock ownership.

19 Q Mr. Morrison, Joint Exhibit 6-F, which is a letter  
20 from Amsterdam to First National City Bank dated December,  
21 1967, Exhibit 7-G is a letter from First National City Bank to  
22 Amsterdam dated December 20, 1967 and Exhibit 8-H is a copy of  
23 the contract between those two banking institutions. I'd like  
24 to show you copies of those if I may.

25 MR. DILL: Your Honor, these Exhibits have already

1 been stipulated to.

2 THE COURT: He may want to ask him a question,  
3 Counsel. Don't interrupt him. Let him put his case in.

4 MR. ROWE: I would like Mr. Morrison to state  
5 whether he obtained these from IFF's files.

6 MS. WESTEN: Well, we're not challenging the  
7 authenticity of the documents.

8 THE COURT: There's no question about that, Mr. Rowe,  
9 I thought maybe you wanted to ask Mr. Morrison something.  
10 about these. There's no question that these came from your  
11 files.

12 MR. ROWE: No, Your Honor, these did not come  
13 from our files. That's the point. If the Government will  
14 concede that they came from the files of Amsterdam or First  
15 National City Bank, I won't pursue this line. I just want to  
16 make it clear that these are not from our files.

17 THE COURT: What difference does it make as long as  
18 they're genuine?

19 MR. ROWE: There is a reason.

20 MS. WESTEN: If Mr. Rowe would like to explain his  
21 reason, perhaps we can understand it. But, they've been  
22 stipulated to and they're in the record.

23 THE COURT: It would seem to the Court here,  
24 apparently this adjustment was made prior to the 90-day letter,  
25 is that right, because I don't see anything about this

1 adjustment in the Notice of Deficiency. Somebody point out to  
2 me where this adjustment appears on the Notice of Deficiency?

3 MS. WESTEN: Which adjustment are you referring to?

4 THE COURT: This capital gain ordinary income  
5 adjustment that we had before.

6 MR. ROWE: Your Honor, may I just ask this witness  
7 one question to dispose of this matter?

8 MR. DILL: It's on the first page or second page,  
9 Your Honor, of the Notice of Deficiency.

10 THE COURT: I've got a schedule here, A through Q, is  
11 that what you're looking at? Adjustments to income?

12 MR. DILL: Your Honor, may I show you Respondent's  
13 copy?

14 THE COURT: You have Schedule A through Q. Now,  
15 which one is it on A through Q?

16 MR. DILL: Your Honor, this adjustment is distinct  
17 and separate from the usual adjustments. It's not on the same  
18 page of the Statutory Notice.

19 THE COURT: Well, now, I have a Notice here that's  
20 one page, that's the printed notice in the deficiency amount.

21 MS. WESTEN: If you'll look at the first page of the  
22 Statutor. Notice statement, Your Honor, it states that it is  
23 held that the purchase by Amsterdam Overseas Corporation of  
24 your contract with the First National City Bank is a sale  
25 where the British pound sterling was not a bona fide transaction.

1                   THE COURT: I don't know. This Notice -- there must  
2 be something missing here.

3                   MS. WESTEN: Well, if you're lacking the Statutory  
4 Notice statement page, Your Honor, we'll be glad to provide one.

5                   THE COURT: Well, first I have the printed page, with  
6 the year and the amount filled in. Right?

7                   MS. WESTEN: Right.

8                   THE COURT: Dated September 25, 1970.

9                   MS. WESTEN: Right.

10                  MR. DILL: Correct.

11                  MS. WESTEN: The next page should be the Statutory  
12 Notice statement.

13                  THE COURT: The next page I have is a Schedule 1.

14                  MS. WESTEN: Well, that's what you're missing.

15                  THE COURT: Schedule 2 and then I jump to page 4, 5,  
16 6, 7.

17                  MS. WESTEN: We will be glad to provide the Court  
18 with a copy of this page.

19                  THE COURT: Let's get a copy of the Statutory Notice  
20 in here in full and then we can question about it.

21                  MS. WESTEN: This is the Petitioner's copy, Your  
22 Honor.

23                  MR. ROWE: As a matter of fact, it's the Petitioner's  
24 office file, Your Honor.

25                  THE COURT: Page 2 is the same schedule, isn't it?

1 Now, where is the long term capital gain and so forth on page  
2 2? There's a blank there on this copy.

3 MS. WESTEN: Page 2 represents adjustments to income,  
4 a supplemental schedule on what we're dealing with here is the  
5 characterization of income.

6 THE COURT: Page 3, adjustments to income, \$113,000.00.  
7 And A through Q and I don't see anything there that fits this  
8 adjustment. Page 4.

9 MS. WESTEN: Well, if Your Honor would like, at the  
10 conclusion of the trial --

11 THE COURT: No, I want to get that straight before we  
12 go any further because I'm trying to find out just what the  
13 Respondent's position is here and it doesn't say anything about  
14 this adjustment in the Statutory Notice, either the one I have  
15 or the one that's in the files of the Petitioner. They're  
16 both alike.

17 MS. WESTEN: It's set out on the Statutory Notice  
18 statement page which follows the covering letter.

19 THE COURT: On page 2?

20 MS. WESTEN: It has no number at the top. It's just  
21 Statutory Notice statement symbols APNYVOR.

22 THE COURT: All right. It is held that the purchase  
23 of so forth are not a bona fide and so forth but where is the  
24 amount? Where is the adjustment? I don't see anything in  
25 there when you add up the adjustments.

1 MS. WESTEN: It's set out separately, the amount of  
2 \$73,715.00.

3 THE COURT: This bona fide transaction statement  
4 isn't in the Statutory Notice of the Petitioner for some reason.  
5 Well, anyway, I assume we can figure out a way to compute the  
6 tax because I point out, if you look at the schedule of  
7 adjustments and make up the \$113,000.00, you won't find this  
8 item in it.

9 MR. DILL: You won't find it, Your Honor, because all  
10 those items have been disposed of.

11 THE COURT: Well, isn't it true, when we get back to  
12 it, that this item must have been in the adjustments of 6/16/69  
13 which resulted in an additional assessment of \$85,000.00?

14 Isn't that what we're talking about? I think you'll find that  
15 the \$73,000.00 deficiency here is attributable to a series of  
16 adjustments here. It must be, of \$113,797.24 although I  
17 don't know how it results in that much of a deficiency. That's  
18 the amount by which the Statutory Notice increases income.

19 MS. WESTEN: It appears, Your Honor, that there may  
20 be a page missing because it looks to me like when we look at  
21 these forms, adjustments to income as of statement schedule  
22 page 2 and the next page is page 4.

23 THE COURT: That's right. I think we're going to  
24 have to have that for the purpose of computation.

25 MS. WESTEN: We've got all that.

1 MR. DILL: We have all the pages, there's no problem  
2 there.

3 THE COURT: Well, there's a big problem.

4 MS. WESTEN: Let's see if we can figure it out.

5 THE COURT: I think you better get the basis of the  
6 prior assessment. There was an earlier assessment here that  
7 was paid. That's the way I would interpret the 90-day letter.  
8 \$85,000.00 which should be included with the return in order  
9 to get up to the present state of affairs. The question I was  
10 going to ask, Ms. Westen, is that the Notice of Deficiency says  
11 first this was disallowed because it wasn't a bona fide  
12 transaction; is that right?

13 MS. WESTEN: Correct.

14 THE COURT: All right. Now, what do you mean by it  
15 wasn't a bona fide transaction?

16 MS. WESTEN: Well, it was stated to you when we made  
17 our opening statement where the Respondent took the position  
18 alternatively that though in form this represented the sale of  
19 a contract for the purchase of pound sterling, in substance  
20 it represented either an agency relationship in which  
21 Amsterdam was acting as the agent of the Petitioner or  
22 alternatively, it was in the nature of a hedging transaction.

23 THE COURT: Well, the hedging has nothing to do with  
24 it being a bona fide transaction.

25 MS. WESTEN: Oh, it does. It relates to the --

1                   THE COURT: Now, now, Ms. Westen, please. Hedging  
2 is -- and I think the 90-day letter properly distinguishes  
3 between hedging. There's nothing about hedging that makes it  
4 any less bona fide. There's hedging done every day in every  
5 market I know of.

6                   MS. WESTEN: By bona fide, we mean the proper  
7 characterization of the transaction.

8                   THE COURT: I mean, by bona fide, one would assume  
9 that you meant that Amsterdam was acting as agent and that this  
10 was a phony sale. Isn't that what you were saying?

11                  MS. WESTEN: We're saying that bona fide relates to  
12 the accurate characterization of a transaction and that it  
13 could be more accurately characterized either as an agency  
14 agreement or --

15                  THE COURT: We have the agreements in evidence,  
16 don't we?

17                  MS. WESTEN: We have the agreements in evidence.

18                  THE COURT: Is there anything in there that would  
19 support the characterizing of an agency agreement?

20                  MS. WESTEN: Oh, yes, indeed.

21                  THE COURT: Well, what is it?

22                  MS. WESTEN: Well, we're going to argue that on  
23 brief, Your Honor.

24                  THE COURT: I know, but can you tell me what there  
25 is in there that leads to characterization as an agency

1 transaction?

2 MS. WESTEN: Well, you'll see when we get into our  
3 cross examination. I'd rather wait until we reach that.

4 THE COURT: Now, the other thing is that -- the  
5 hedging. What do you understand by hedging?

6 MS. WESTEN: We understand by hedging that one  
7 company, in effect, acts in a particular manner in order to  
8 protect its income or its profits. It's entering into an  
9 agreement which is analogous to insurance agreement.

10 THE COURT: Isn't it true, Ms. Westen, that the  
11 hedging type of cases you have to be pretty well able to match  
12 your purchases and your sales? In other words, as I said when  
13 National Cash Register made a sale of Marks, they immediately  
14 went out and sold the Marks short in order to eliminate  
15 fluctuation from their operational income.

16 MS. WESTEN: Well, we think that insurance is  
17 broader than that, Your Honor.

18 THE COURT: I'm talking about hedging. We're not  
19 talking about insurance now, we're talking about hedging.

20 MS. WESTEN: Well, what we're saying is that hedging  
21 is analogous to insurance.

22 MR. DILL: Your Honor, our hedging argument is not  
23 our main argument.

24 THE COURT: The reason I raise these questions is  
25 I couldn't find anything in the 90-day letter, now that I see

1 the language, we have the bona fide argument which I would  
2 assume to mean it's the Swiss bank account type of deal that  
3 you're talking about. That there wasn't really a sale. Now,  
4 this witness is certainly proper for him to testify this  
5 Amsterdam outfit was an independent company and had no  
6 relationship with the taxpayer, assuming that they thought they  
7 could make \$10,000.00 for a few days risk, they'd be willing  
8 to take the chance. That's how I interpret the transaction.  
9 Go ahead with your examination.

10 MR. ROWE: Your Honor, it was in anticipation of the  
11 Government's argument, --

12 THE COURT: That's right.

13 MR. ROWE: -- that I introduced this line of  
14 questioning. I have to head it off.

15 THE COURT: You may proceed, Mr. Rowe.

16 MR. ROWE: And the only purpose of asking whether  
17 Exhibits -- asking the witness, which I now ask the witness,  
18 whether Exhibits 6-F, 7-G and 8-H came from Petitioner's files  
19 or not is to establish that they did not and that that's  
20 further proof of the independence of the two parties.

21 THE COURT: Now, do you know that of your own  
22 knowledge, that these did not come from the Petitioner's files?

23 THE WITNESS: I have never seen these before in  
24 searching the files. I never saw this before.

25 MR. ROWE: Now, you also stated that your search and

1 review of the files did not indicate any cross ownership of  
2 stock between the two companies.

3 THE WITNESS: That is correct.

4 BY MR. ROWE:

5 Q Now, did your search of the files address itself and  
6 what were the results if it did, of any other agreements, that  
7 is, any other agreements other than this pound sterling  
8 contract between the two companies?

9 A I did not find any other.

10 Q And you searched for that?

11 A Yes.

12 Q May we now come to Exhibit 23-W, Your Honor. I  
13 show you a copy of Exhibit 23-W and there's a copy for Your  
14 Honor. Mr. Morrison, this is a stipulated Exhibit. Will you  
15 tell you Court who prepares the statement that you're looking  
16 at? What is done with the statement? What the various  
17 columns signify.

18 A The two left-hand columns are prepared by IFF  
19 Great Britain Limited in pound sterling.

20 Q Excuse me, the two left columns, you're talking  
21 about the year 1966 at this point?

22 A That is correct.

23 Q Or, you're talking about the year that shows  
24 December, 1965 and 1966?

25 A That's correct.

1           Q     So those two, under 31 December 1965 and 31 December  
2     1966 are prepared in England?

3           A     They are prepared in England and they represent the  
4     pound sterling figures. The portion to the right of the  
5     column marked December 31st, 1966, are translation of the  
6     pound figures to dollars, prepared in New York.

7           Q     And the items that appear right under the words  
8     Statement of Financial Position are merely the numbers and  
9     description of various accounts under which you put various  
10    expenditures and income items, is that correct?

11          A     That is correct.

12          Q     Now, coming to the right-hand part of this statement,  
13    the translation. Will you explain to the Court what occurs  
14    there? For example, I see the figure 280. What does that  
15    mean?

16          A     That was the exchange rate between the pound sterling  
17    and the dollar, December, 1966 and so you multiply the pound  
18    sterling figure by 2.80 and arrive at the dollar figure.

19          Q     Then there's three figures there, one says dollar  
20    equivalence, one says journal entries in dollars and then  
21    final dollar amount. Would you just explain to the Court what  
22    those are?

23          A     Okay. The dollar equivalent is the straight dollar  
24    translation of the pound sterling. The next is the minor or  
25    adjustments made in accounts in New York and the final column

1 on the right is the -- what we ultimately, we take the Great  
2 Britain figure and the other figures and add them together for  
3 a world-wide consolidation in dollars. The journal entries are  
4 adjustment columns.

5 Q Now then, would you take the next sheet which appears  
6 to be statement of income and retained earnings and without  
7 going into the same detail because it does appear to be self-  
8 explanatory, you make the same translation there as far as the  
9 income statement is concerned, is that correct?

10 A Yes. In this case, the three columns on the left-hand  
11 portion are in pound sterling and then there is a dollar  
12 translation, rate column and then the dollar equivalent figures.

13 Q These figures are for the British company. You do  
14 the same thing for all of the foreign subsidiaries.

15 A All of our foreign subsidiaries, that is correct.  
16 Local currency into dollars.

17 Q And what do you do with the dollar figures when  
18 you've got them all?

19 A We take the dollar figures, consolidate them  
20 world-wide to arrive at a world-wide consolidated financial  
21 statement.

22 Q In dollars.

23 A In dollars.

24 Q Would you please go back to the balance sheet again?  
25 If the pound were devalued, under the practice followed by your

66

1 company, what figures would change?

2 A Basically all the items under current assets and  
3 current liabilities or the net current asset figures would be  
4 at a lower translation rate.

5 Q The fixed asset figures and other figures on the  
6 balance sheet would not be changed.

7 A That is correct.

8 Q The only figures you would change, in substance,  
9 would be the net current assets.

10 A The net current assets, in substance, would be the  
11 figures translated at a different rate.

12 Q Coming to the income statement, what do you do there?  
13 Supposing the pound was devalued in the middle of the year,  
14 what do you do?

15 A If the pound were devalued in the middle of the year,  
16 you would break the year apart and translate that part of the  
17 year which was before the currency change at one rate and the  
18 portion of the year after the currency rate change at the new  
19 rate.

20 Q So, the effect of the devaluation in the case of the  
21 British subsidiary would be to reduce the dollar value of the  
22 British subsidiary as carried on the consolidated balance  
23 sheet, is that correct?

24 A That is correct.

25 Q The income statement would show less income.

1 A That is correct.

2 Q Now, you referred to the fact that upon devaluation  
3 certain figures would be reduced both on the balance sheet and  
4 in the income statement. The changes that you make do not  
5 reflect or represent any actual transfers of dollars or anything  
6 of value from one company to another, is that right?

7 A That is correct.

8 Q It's a hypothetical conversion only for the purpose  
9 of preparing consolidated statements.

10 A It's for preparation of the consolidated financial  
11 statements, that's correct.

12 Q Mr. Morrison, are you familiar with the term  
13 exposed assets as applied to the effect of devaluation upon a  
14 U.S. company's investment in or interest in a foreign  
15 subsidiary?

16 A Yes, I am.

17 Q What's the term mean?

18 A Basically, the term would be the net current assets  
19 because those are the assets that would be reduced in value if  
20 there is a devaluation of the currency.

21 Q Do you know that in and around November or December,  
22 1966, that your department made a determination of exposed  
23 assets in IFF's case?

24 A Yes.

25 Q Is there an Exhibit before the Court which shows what

1 that would have been approximately?

2 A Yes. The prior letter that we referred to from Mr.  
3 Reid to Mr. Ragoletti.

4 Q What about the Exhibit you're looking at now?

5 A And the Exhibit I'm looking at now would give the  
6 basic figure also.

7 Q Which, in this case, as I understand to be the  
8 net current asset position there?

9 A Yes, at the end of 1966, a 520 balance, 665,000  
10 pounds.

11 Q Now, this statement was actually prepared after the  
12 end of the year but in accordance with your knowledge of the  
13 practices followed by the company in and around November or  
14 the early part of December, 1966, they would have had a pretty  
15 good estimate of that net current asset position of the  
16 British subsidiary; is that correct?

17 A That is correct.

18 MS. WESTEN: Your Honor, I'm going to object to that  
19 because Mr. Morrison --

20 THE COURT: Objection sustained. The answer will be  
21 stricken. Ask the witness -- do you still follow this  
22 practice or are you hedging now?

23 THE WITNESS: We are not hedging..

24 THE COURT: You're not hedging. In other words, you  
25 don't attempt to cover your current sales, purchases or even

1 your current earnings, as they accrue.

2 THE WITNESS: We never have. This is a calculation  
3 based on exposed assets.

4 BY MR. ROWE:

5 Q Now, Mr. Morrison, coming back to the question that  
6 was objected to and the objection was sustained, according to  
7 your knowledge of the company's practices, is there a figure  
8 on this Exhibit 23-W which shows what would be deemed the  
9 exposed assets of your company?

10 A This is 23-W?

11 MS. WESTEN: Your Honor, excuse me. It seems to me  
12 that Mr. Morrison has already testified that the term exposed  
13 assets essentially meant current assets, liquid assets and the  
14 statements are in evidence and they speak for themselves.

15 THE COURT: That's right. I think it does.

16 BY MR. ROWE:

17 Q Mr. Morrison, it's been stipulated that IFF, in  
18 December, 1966, sold for delivery in 1968 1,100,000 pounds  
19 sterling. Do you know, from your review of the company  
20 records, where that figure came from?

21 A Yes, I do.

22 Q Would you state to the Court where it came from?

23 A It came from the net current asset position.

24 Q And would you explain how it was related to the  
25 net current asset position?

1           A     Yes. The net current assets were roughly  
2     1,500,000.00 or a little over 500,000 pounds. The amount  
3     entered into in the contract was 1,100,000 pounds which is  
4     roughly double the figure because there would be a tax,  
5     potential tax on that contract and so they protected for the  
6     full amount including the tax.

7           MS. WESTEN: I object to that, Your Honor, he's --

8           THE COURT: Objection sustained. The answer will  
9     be stricken. This witness doesn't know what they did.

10           BY MR. ROWE:

11           Q     Do you have information as to what they did?

12           A     Yes, I do.

13           Q     Will you state the basis of your information?

14           A     It is the letter from Mr. Reid.

15           THE COURT: That's in evidence. Let it speak for  
16     itself.

17           BY MR. ROWE:

18           Q     Now, IFF, the U.S. company, does not file a U.S. tax  
19     return in which the results of operations of its foreign  
20     subsidiaries are consolidated, does it?

21           A     That's correct.

22           Q     It's results are not combined with those of foreign  
23     subsidiaries.

24           A     That's correct.

25           Q     Now, I ask you to look at Joint Exhibit 16-P. Mr.

1 Morrison, that Exhibit shows that other than the contract with  
2 First National City Bank, a list of obligations of pound  
3 sterling incurred by Petitioner on account of transactions in  
4 the years 1966, 1967 and 1968, the dates paid, check numbers,  
5 invoice numbers and the amount of pound sterling shown, were  
6 those figures obtained under your direction?

7 A Yes, I compiled them.

8 Q And these were all there were of that nature in those  
9 years.

10 A That's correct.

11 Q Taking those same years, Mr. Morrison, 1966, 1967  
12 and 1968, did Petitioner IFF, sell any products or render any  
13 services to any person or incur expenses on any person's  
14 behalf where the amount due Petitioner therefore was payable  
15 by or billed to such persons in pounds sterling?

16 A No.

17 Q Why not?

18 A Because all billings --

19 MS. WESTEN: Objection. It's calling for an  
20 opinion and conclusion with respect to years which the witness  
21 was not employed.

22 THE COURT: Overruled.

23 THE WITNESS: It is the policy of the company, the  
24 U.S. taxpayer.

25 THE COURT: I'll have to sustain the objection if

1 this witness is objecting as to policy. If he's examined, he  
2 can testify as to what the books and records show, that's one  
3 thing but he can't testify as to what the policy was.

4 MR. ROWE: I'll restate the question if I may.

5 Taking these same years, Mr. Morrison, 1966, 1967 and 1968,  
6 and I ask you whether you made a review of and are familiar  
7 with the books and records of IFF so that you can answer the  
8 following question: Did Petitioner IFF sell any products or  
9 render any services to any person or incur expenses on any  
10 person's behalf where the amount due Petitioner therefore,  
11 amounts due Petitioner therefore were payable by or billed to  
12 such persons in pound sterling?

13 THE WITNESS: In my review of the records, I found  
14 no receivables in pound sterling.

15 MR. ROWE: And I now ask you: That's consistent,  
16 is it not, with your knowledge of the company practice?

17 THE WITNESS: Yes, it is.

18 MR. ROWE: And what is that company practice?

19 THE WITNESS: The company practice is to bill  
20 everything in U.S. dollars.

21 MR. ROWE: Now, Mr. Morrison, returning if you will,  
22 to the 1,100,000 pounds which we've been talking about and  
23 which is the subject of this lawsuit, based upon your review  
24 of the company's records and your familiarity with the  
25 company's records, do you know whether or not that amount

1 related to any payment which IFF expected to receive in pound  
2 sterling?

3 MS. WESTEN: Objection, Your Honor. It calls for an  
4 opinion and conclusion. I mean, the records are in evidence.

5 THE COURT: What is the purpose of this line of  
6 questioning, Mr. Rowe?

7 MR. ROWE: The purpose of this line of questioning is  
8 the following: We want to argue and there's no -- we wish to  
9 argue what is the fact, Your Honor, and that is that this  
10 1,100,000 pound transaction was measured by the net current  
11 asset position of the British subsidiary.

12 THE COURT: Well, I know, but you can argue that all  
13 you want but it's double the net current asset position. It's  
14 more than double and to say that's after taxes is a bunch of  
15 garbage. You're not talking about a 50 per cent tax rate here.  
16 You're arguing that the tax rate should be at least half, not  
17 more than half of that. All right, so -- I mean, you can play  
18 with these figures all you want but I don't see how you can  
19 come up with any relationship of a short sale, anything on this  
20 Exhibit.

21 MR. ROWE: Well, Your Honor, it is directly related  
22 to the --

23 THE COURT: That's what you're saying but the figures  
24 don't prove that and there's nobody in the Court Room that can  
25 testify to that.

1 MR. ROWE: Well, Your Honor, if I may address myself  
2 to that. The fact of it is that --

3 THE COURT: You're not qualified to testify to it,  
4 Mr. Rowe.

5 MS. WESTEN: Your Honor, these are all arguments  
6 that he can make on brief.

7 THE COURT: You can make all the arguments in your  
8 brief you want but I haven't heard any rational basis upon  
9 which anybody can tie that figure into anything. I'm not sure  
10 it makes any difference with your case whether or not they just  
11 thought in their own minds this is a good time to sell pounds.  
12 I don't see anything wrong with that.

13 MR. ROWE: Your Honor, may I read -- Exhibit 27 has  
14 been received in evidence and may I read to you a sentence?

15 THE COURT: I can read, Mr. Rowe.

16 MR. ROWE: It refers to the taxes.

17 MS. WESTEN: But it speaks for itself.

18 THE COURT: It speaks for itself, whatever it says.

19 MR. ROWE: Now, Mr. Morrison, based upon your review  
20 of the records and your familiarity with the records, did IFF,  
21 in 1966, 1967 and 1968 own any pound sterling or any assets,  
22 the value of which was materially affected by the exchange rate  
23 per pound sterling other than its investment in and interest in  
24 the British subsidiary?

25 MS. WESTEN: Objection, it calls for an opinion and

1 a conclusion which can be drawn --

2 THE COURT: Objection overruled. All of this is in  
3 the record, though, Mr. Rowe. Nobody argues that they had any  
4 pounds sterling in their own account but the British subsidiary  
5 had some, certainly. I don't know, maybe some of the other  
6 subsidiaries may have had pound sterling accounts. We don't  
7 know.

8 THE WITNESS: No, they did not have any other.

9 MR. ROWE: I have no further questions of this  
10 witness, Your Honor.

11 THE COURT: All right, Ms. Westen, you may cross  
12 examine.

13 **CROSS EXAMINATION**

14 BY MR. DILL:

15 Q Mr. Morrison, has IFF entered into any contracts  
16 similar to the one here from First National City Bank where  
17 IFF has either gone long or short in order to protect itself  
18 from fluctuations in currency in Great Britain or in any other  
19 countries in which IFF United States has subsidiaries?

20 MR. ROWE: Your Honor, may I object to the question?

21 THE COURT: Let's get a time period for that, you're  
22 talking about when? '65? '66?

23 BY MR. DILL:

24 Q All right, we'll make it '65, '66, '67 and '68.

25 A '65 no other one, '66 no other one, '67, '68, there

1 were some other contracts, yes.

2 Q Of a similar nature to this?

3 A Yes.

4 Q Do you recall whether there was a gain or loss in  
5 the transactions?

6 A There was no currency realignment so there would have  
7 been a loss.

8 Q How was the loss treated?

9 MR. ROWE: May I object to the question?

10 THE COURT: Overruled.

11 THE WITNESS: The loss was treated, to the best of  
12 my knowledge, as an ordinary loss.

13 BY MR. DILL:

14 Q Therefore, deductible fully from any income received  
15 by IFF.

16 A That's correct.

17 Q Mr. Morrison, did IFF receive a written acknowledge-  
18 ment from First National City Bank releasing them as primary  
19 obligor of the contract to deliver the 1,100,000 British  
20 pounds sterling?

21 MR. ROWE: Object. The record speaks for itself on  
22 that.

23 MR. DILL: There's nothing in the record on that,  
24 Your Honor. That's why I'm asking the question.

25 THE WITNESS: There's nothing I can recall.

1 BY MR. DILL:

2 Q Is it your testimony that IFF did not receive an  
3 acknowledgement from First National City Bank releasing them as  
4 primary obligor of the contract? Please answer yes or no.

5 A They did not receive it to the best of my knowledge,  
6 that's right.

7 Q On December 29th, 1966, the British pound was  
8 trading at approximately \$2.79. Can you please tell the Court,  
9 Mr. Morrison, why the parties agreed, on the same date,  
10 December 29th, 1966, that First National City Bank would  
11 purchase the pounds for approximately \$2.77. In other words,  
12 can you explain to us what this spread represents?

13 A The spread is three-quarters of one per cent which  
14 is the risk involved of making the contract more than a year  
15 hence.

16 MR. DILL: We have no further questions, Your Honor.

17 MR. ROWE: May I ask one question directed to you?

18 MR. DILL: Directed to me?

19 MR. ROWE: No, directed to your cross examining.

20 MR. DILL: Certainly.

21 MR. ROWE: The other transactions to which the  
22 Government referred were closed, were they not?

23 THE WITNESS: No.

24 MR. ROWE: The contracts were not sold.

25 THE WITNESS: The contracts were not sold, that is

1 correct. They were a different situation.

2 THE COURT: Well, how did you get an ordinary income  
3 charge for them?

4 THE WITNESS: Those years are still in question.  
5 They haven't been resolved.

6 THE COURT: In other words, did you buy pounds or  
7 sell pounds or do you remember?

8 THE WITNESS: I don't remember but it would have  
9 been the same type of transaction as this one.

10 THE COURT: In other words, you sold --

11 THE WITNESS: Sold the pounds forward.

12 THE COURT: Expecting a devaluation.

13 THE WITNESS: Expecting a devaluation and they would  
14 have been.

15 THE COURT: So you had -- your loss was the amount  
16 that you paid for the future.

17 THE WITNESS: That is correct. And those years have  
18 not been resolved.

19 MR. ROWE: Is it your recollection or your knowledge  
20 that those contracts were not disposed of?

21 THE WITNESS: That is correct.

22 MR. ROWE: They were not sold as this contract  
23 subject of the dispute, was sold.

24 THE WITNESS: That is correct.

25 MR. ROWE: Now, Your Honor, I would like to --

1 THE COURT: How far in advance was this contract  
2 sold?

3 THE WITNESS: It was sold about two weeks before.

4 THE COURT: That's not much of a sale is it?

5 MR. ROWE: A lot can happen in two weeks, Your Honor.  
6 Particularly in this whole business of currency.

7 THE COURT: Not in these days, this was in '67. As  
8 I recall, the British were frowned on quite universally for  
9 taking that action, weren't they?

10 THE WITNESS: Well, they may have been frowned on but  
11 their currency was very weak.

12 MS. WESTEN: Your Honor, this is calling for opinions  
13 and conclusions.

14 THE COURT: We're just talking about matters that are  
15 common knowledge from the press and getting back to the time.  
16 The Counsel for the Petitioner, Ms. Westen, started talking  
17 about today's conditions in the money market. Well, the  
18 conditions in '67, as the Court attempted to point out, bear  
19 no analogy to the conditions today.

20 MS. WESTEN: We're not even considering that.

21 THE COURT: But, I still have trouble finding out  
22 what your position is, Ms. Westen.

23 MR. ROWE: May I stipulate on the record, by the way  
24 that the pound was devalued on November 17th. It doesn't  
25 appear in the record anywhere at this point.

1 MS. WESTEN: In our original Stipulation, I think  
2 we have the value on that date.

3 MR. ROWE: It doesn't show that that was the date of  
4 devaluation.

5 THE COURT: I don't know it makes that much  
6 difference, Counsel. Now, I don't know, I think you may have  
7 to get together and put in that prior RAR or whatever it is,  
8 on the basis of that assessment because I can't make head or  
9 tails out of the figures in the 90-day letter.

10 MR. DILL: Your Honor, Respondent would like to make  
11 a brief closing remark to clarify Respondent's position here.

12 THE COURT: All right. That's just what I'm looking  
13 for. You may be excused Mr. Morrison.

14 MR. DILL: From Respondent's observations here today,  
15 Your Honor, it appears Petitioner has very neatly tried to  
16 zero in on the bona fide transactions between IFF and  
17 Amsterdam, the sale, possibly distinguish in certain cases,  
18 also to protect its capital assets as far as subsidiaries but,  
19 unfortunately, Petitioner has neglected Code Section 1233 that  
20 Congress saw fit to enact as dealing with situations identical  
21 to this, where a short sale has taken place, a gain is treated  
22 as a short-term capital gain. There's no way around Section  
23 1233. Petitioner is just trying to completely circumvent the  
24 statute.

25 THE COURT: Well, if that's true, why doesn't the

1 90-day letter say that?

2 MR. DILL: The 90-day letter says that, Your Honor.

3 THE COURT: That's the problem. I don't find it.

4 MR. DILL: The 90-day letter says --

5 THE COURT: Let me go get the copy.

6 MR. DILL: I have a copy of the Code letter.

7 THE COURT: That's been the problem with this case.

8 The Respondent starts out and the first allegation is that the  
9 thing is a phony. That's what I would say when it isn't bona  
10 fide, that they just sold it themselves. That's what I would  
11 interpret from that or had an accommodation by it. Now  
12 you're over into a different proposition. You're saying let's  
13 assume that we do have a legitimate sale here.

14 MR. DILL: Respondent, Your Honor, has taken an  
15 alternative position on this, Your Honor.

16 THE COURT: But the alternative position up until  
17 your statement right now was that it was a hedging transaction.

18 MS. WESTEN: Not so, Your Honor.

19 THE COURT: What does the 90-day letter say?

20 MS. WESTEN: It is the Respondent's position that  
21 the word bona fide goes to the proper characterization of the  
22 transaction.

23 THE COURT: Oh, now, Ms. Westen, I'm sorry but I'm  
24 just not going to argue that point with you. No reasonable  
25 lawyer, Ms. Westen would understand that by use of the term

1 bona fide anybody is referring to Section 1233.

2 MS. WESTEN: Well, this has been the position of the  
3 Respondent since the administrative consideration of the case  
4 in the Appellate Division and there has been no change in  
5 Respondent's position.

6 THE COURT: Well, I'm sorry you didn't write the 90-  
7 day letter a little better then. This talks about commodity  
8 futures, doesn't it? Section 1233?

9 MR. DILL: Section 1233 talks about short-term --  
10 short sales, gains and losses of short sales. It doesn't limit  
11 itself to commodities or stocks or futures.

12 MR. ROWE: I beg your pardon, it does. Look at the  
13 definition of property.

14 THE COURT: Well, we'll take a look at that in the  
15 briefs but, as I say, we get over to the fact that in G it  
16 says that it shan't apply to a hedging transaction in commodity  
17 futures.

18 MR. DILL: Your Honor, there are a voluminous amount  
19 of cases in this area where taxpayers have realized gain and  
20 in order to take advantage of capital gain have treated it as -

21 THE COURT: I was waiting for you to get to that  
22 area. We had hearings, didn't we, you could go out and buy  
23 a Government bond for 75 cents on the dollar and instead of  
24 waiting until maturity, you sold it a month before maturity,  
25 you got a capital gain. I can remember that there were

1      rulings on that point, weren't there? Isn't that right?

2                    MR. DILL: There might have been.

3                    THE COURT: Okay. But anyway, you put all of that  
4      in your briefs. Let's have some brief dates here, Mr. Gross.

5                    MR. ROWE: Your Honor, may we go off the record for  
6      a minute?

7                    THE COURT: We may.

8                    (Whereupon, a discussion was had off the record.)

9                    THE COURT: Opening briefs will be due September 30th.

10                  THE CLERK: Would you prefer to make that October 1?  
11      September 30 is a Sunday.

12                  THE COURT: Let's make it October 1. And the reply  
13      briefs will be due November 1. Let's keep them short and brief.  
14      Thank you.

15                  MR. ROWE: Thank you very much, Your Honor. I  
16      appreciate your coming up here for this trial.

17                  (Whereupon, the case was closed at 11:15 a.m.)

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62 T. C. No. 26

UNITED STATES TAX COURT

INTERNATIONAL FLAVORS & FRAGRANCES INC., Petitioner  
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 7768-70.

Filed May 16, 1974.

Petitioner and its foreign affiliates are engaged worldwide in the manufacture and distribution of flavoring extracts. In order to offset any loss which might be sustained in event of the devaluation of the British pound sterling, petitioner entered into a short sale contract for pounds sterling. After the pound was devalued, but before the delivery date, petitioner either sold or closed out its contract. HELD: The gain to petitioner on the transaction is taxable as ordinary income under the principles of Corn Products Co. v. Commissioner, 350 U.S. 46 (1955).

George Rowe, Jr., and Michael J. Gaynor, for the petitioner.

Marion L. Westen and Warren W. Dill, for the respondent.

SERVED MAY 16 1974

QUEALY, Judge: Respondent has asserted a deficiency in the Federal corporate income tax of petitioner for the taxable year 1967 in the amount of \$73,715.

Certain concessions having been made by the parties, the following issues remain for decision:

(1) Whether petitioner's gain on a contract for the short sale of 1.1 million pounds sterling, entered into with First National City Bank and subsequently sold or transferred to Amsterdam Overseas Corp. just prior to the closing date, is taxable as ordinary income under the doctrine of Corn Products Co. v. Commissioner, 350 U.S. 46 (1955), making the gain realized on the transfer thereof taxable as ordinary income.

(2) Alternatively, whether the gain to petitioner on the above transaction should be taxable under the provisions of section 1233<sup>1</sup> on the basis that Amsterdam was, in substance, acting as a broker for petitioner in purchasing the pounds sterling used to close out the short sale.

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All statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated.

- 3 -

#### FINDINGS OF FACT

Some of the facts have been stipulated by the parties. Such facts and the exhibits attached thereto are incorporated herein by this reference.

International Flavors & Fragrances Inc. (hereinafter referred to as "petitioner" or "IFF (U.S.)") is a New York corporation with its principal place of business in New York, New York. Petitioner filed a United States corporate income tax return (Form 1120) and an information return with respect to controlled foreign corporations (Form 2952), respectively, for the taxable year 1967 with the district director of internal revenue, Manhattan District, New York, New York.

IFF (U.S.) is engaged in the creation and manufacture of flavor and fragrance products used by other manufacturers to impart or improve flavor or fragrance in a variety of consumer products. Its activities are conducted on a worldwide basis through numerous foreign corporations which it, directly or indirectly, owns or controls.

- 4 -

IFF (U.S.) prepares consolidated financial statements which it publishes regularly to its shareholders and to the public. For the purpose of such consolidated statements, the accounts of its foreign affiliates, which are expressed in foreign currencies, are converted into United States dollars. The accounts of its foreign affiliates, however, are not consolidated for United States income tax purposes. No other financial statements are published.

Of primary concern to the present inquiry is the relationship between IFF (U.S.) and its foreign affiliate, International Flavors & Fragrances I.F.F. (Great Britain) Ltd. (hereinafter referred to as "IFF (G.B.)"). IFF (G.B.) is a wholly-owned foreign subsidiary of International Flavors & Fragrances I.F.F. (Nederland) N.V. (hereinafter referred to as "IFF (Holland)") which, in turn, is wholly owned by IFF (U.S.). IFF (G.B.) has manufacturing, research, and administrative facilities in Enfield, England. It has additional manufacturing facilities in Haverhill, England.

- 5 -

During the latter part of 1966, IFF (U.S.) became concerned about a possible devaluation of the British pound sterling and the adverse affect it would have in converting the operations of IFF (G.B.) into dollars for purposes of its annual consolidated statement. In a letter to the comptroller in charge of European operations for the company, H. G. Reid, Financial Vice President of IFF (U.S.), suggested that the company sell short a sufficient amount of British pounds sterling to cover, on an after-tax basis, the exposed net current assets of IFF (G.B.), approximated to be, in terms of dollars, \$1,600,000. Reid accordingly recommended the purchase of a 1-year pounds sterling contract in the dollar equivalent of \$3,000,000, since on an after-tax basis, the protection afforded from such contract would be only 53 percent thereof.

On December 29, 1966, IFF (U.S.) entered into a written contract with First National City Bank of New York (hereinafter referred to as "FNCB") pursuant to which IFF (U.S.) sold to FNCB 1.1 million British pounds sterling at \$2.7691 per pound, delivery and payment to be made on January 3, 1968. The price \*

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FNCB agreed to pay per pound was approximately three-fourths of 1 percent below the then prevailing dollar-pound exchange rate of \$2.7918. The discount represented consideration for the risk to FNCB in writing a 1-year contract.

The contract provided that if, prior to the closing date, the market value of pounds sterling exceeded the exchange rate which FNCB was required to pay thereunder, FNCB could request IFF (U.S.) to deposit, as security for its own obligation under the contract, cash or its equivalent. IFF (U.S.) was additionally subject to certain penalties for noncompliance with the terms of the agreement. The contract further provided that FNCB had the power to place liens on any funds of IFF (U.S.) that were or might come into the possession or control of FNCB to enforce its rights under the contract.

IFF (U.S.) had the following dollar deposits on account with FNCB as of the following dates:

December 31, 1966	\$ 302,616.60
December 20, 1967	688,691.19
January 3, 1968	1,928,354.37

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On November 18, 1967, the British government devalued the pounds sterling in terms of the U.S. dollar from \$2.80 to \$2.40.

On December 20, 1967, IFF (U.S.) entered into an agreement with Amsterdam Overseas Corp. (hereinafter referred to as "Amsterdam"), a large international banking institution located at 70 Pine Street, New York City. Neither IFF (U.S.) nor Amsterdam held stock in the other. The agreement, which was in letter form from IFF (U.S.) to Amsterdam and accepted by Amsterdam, read in pertinent part, as follows:

Enclosed is the original of our agreement of December 29, 1966 with First National City Bank which we hereby sell to you today for \$387,000. This sale is on the understanding that you will fulfill the obligation to deliver Sterling 1.1 million to First National City Bank on January 3, 1968 without recourse to us.

On the same day as the above agreement was entered into, the following events also transpired:

- (1) IFF (U.S.) notified FNCB that it had sold its contract with FNCB to Amsterdam.

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(2) Amsterdam notified FNCB that it had bought the contract. It agreed to assume liability thereunder if FNCB would confirm its intent to pay the sum of \$3,046,010 upon the delivery of 1.1 million pounds sterling on January 3, 1968.

(3) At 4:18 p.m., Amsterdam received notification from FNCB of its approval of Amsterdam's purchase of the contract. FNCB also confirmed that on January 3, 1968, it would credit the dollar account of Amsterdam with the difference between its own obligation under the contract, \$3,046,010, and the dollar cost to Amsterdam of purchasing from FNCB, at the prevailing rate of exchange, the 1.1 million pounds sterling needed to close out the contract on such date.

(4) At 4:30 p.m., Amsterdam purchased 1.1 million pounds sterling at the rate of \$2.4080 from FNCB for delivery on January 3, 1968.

On December 21, 1967, Amsterdam sent a check to IFF (U.S.) in the amount of \$387,000 representing the price agreed upon for the purchase of the contract.

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On January 3, 1968, Amsterdam closed out the contract with the 1.1 million pounds sterling purchased short from FNCB on December 20, 1967. The net gain to Amsterdam on the transaction was \$10,210.

In 1967, IFF (G.B.) paid the dollar equivalent of \$476,000 in dividends to IFF (Holland). In the same year, IFF (U.S.) received the dollar equivalent of \$1,421,136 in dividends from IFF (Holland).

With respect to IFF (G.B.), its assets and liabilities per books, stated in British pounds sterling, for the years 1966-1968 were as follows:

IFF (G.B.) COMPARATIVE BALANCE SHEET 1966-1968

	<u>1966</u>	<u>1967</u>	<u>1968</u>
Current Assets:			
Cash on Hand	2,191	7,439	2,389
Marketable Securities	-	135,000	40,000
Notes Receivable - Trade	9,155	12,182	7,718
Accounts Receivable - Trade and Affiliate and other	433,433	571,521	1,022,208
Allowance for Bad Debts	(11,818)	(13,805)	(15,451)
Inventories	522,699	578,774	734,195
Prepaid Expenses and Deferred Charges	<u>19,369</u>	<u>19,973</u>	<u>21,927</u>
Total Current Assets:	975,029	1,311,084	1,812,986
Other Assets:			
Loans to Employees - Long Term	25,561	20,143	2,497
Fixed Assets	752,257	840,863	1,096,963
Less Accumulated Depreciation	<u>(248,334)</u>	<u>(284,885)</u>	<u>(327,093)</u>
Total Current and Other Assets	<u>1,504,513</u>	<u>1,887,205</u>	<u>2,585,353</u>
Current Liabilities:			
Notes Payable - Short Term	-	-	95,958
Accounts Payable - Trade and Affiliate	120,826	209,443	236,551
Taxes Withheld from Employees	5,807	6,177	8,026
Other Accounts Payable and Accrued Expenses	35,099	38,474	28,788
Accrued Taxes on Income	<u>292,632</u>	<u>336,309</u>	<u>540,389</u>
Total Current Liabilities	454,364	590,403	909,712
Long-Term Liabilities:			
Reserves for Retirement Benefits and Pensions	4,607	4,690	8,690
Deferred Taxes on Income	<u>33,508</u>	<u>42,952</u>	<u>91,138</u>
Total Current and Long-Term Liabilities	<u>492,479</u>	<u>638,045</u>	<u>1,009,540</u>
Excess of Assets over Liabilities	1,012,034	1,249,160	1,575,813
Shareholders Equity:			
Capital Stock Issued and Outstanding	250,000	250,000	250,000
Retained Earnings	<u>762,034</u>	<u>999,160</u>	<u>1,325,813</u>
Total Shareholder Equity	1,012,034	1,249,160	1,575,813

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The reconciliation of retained earnings of IFF (G.B.) per books, stated in British pounds sterling, for such years was as follows:

Retained Earnings 12/31/65	652,393
Net Income for year 1966	329,641
Total	<u>982,034</u>
Less: Dividends declared	<u>220,000</u>
Retained Earnings 12/31/66	<u>762,034</u>
Retained Earnings 12/31/66	762,034
Net Income for year 1967	407,126
Total	<u>1,169,160</u>
Less: Dividends Declared	<u>170,000</u>
Retained Earnings 12/31/67	<u>999,160</u>
Retained Earnings 12/31/67	999,160
Net Income for year 1968	517,442
Total	<u>1,516,602</u>
Less: Dividends Declared	<u>190,789</u>
Retained Earnings 12/31/68	<u>1,325,813</u>

During each of the years 1965, 1966, and 1967, IFF (G.B.) purchased \$559,538, \$626,850, and \$855,113 worth of raw materials from IFF (U.S.), respectively. The billings were made in dollars and as of December 31, 1967, there was an unpaid balance of \$175,632. Correspondingly, IFF (U.S.) incurred obligations in pounds sterling of 15,888-0-8, 13,348-15-1, and 11,127-19-1 on account of various raw materials purchased from and services rendered by IFF (G.B.) in each of such years.

IFF (G.B.) also owed certain dollar amounts pursuant to an agreement entered into with IFF (U.S.) on January 1, 1963. In substance, the agreement provided a formula by which IFF (G.B.) was to share the cost of making certain management services of key personnel from IFF (U.S.) and its foreign affiliates, including IFF (G.B.), available to the affiliated group on an international basis. It also set forth the basis on which IFF (G.B.) would share in certain research expenses incurred by IFF (U.S.) and IFF (Holland) from which it derived some benefit. The net dollar amounts owed under such agreement were as follows:

	<u>1965</u>	<u>1966</u>	<u>1967</u>
International Management Group Expense	\$ 65,090	\$164,162	\$172,777
Share of Group Basic Flavor Research Expense	47,874	63,192	90,800
Net Share of Basic Auromatic Chemicals Research Expense	<u>84,635</u>	<u>128,769</u>	<u>177,336</u>
Total	\$197,599	\$356,123	\$440,913

The billings under the agreement were made quarterly. The balance due for the last quarter of 1966

was \$81,467, while the balance for the last quarter of 1967, during which the pound was devalued, was \$119,304.

Except as described above, no other obligations were incurred between the parties during the period of 1965-1968.

In addition to the transaction in question, the petitioner made short sales of British pounds sterling in 1967 and 1968 with respect to which losses were sustained. In the determination of its tax liabilities for those years, such losses were deducted as ordinary losses.

On its corporate return for the taxable year 1967, IFF (U.S.) reported the \$387,000 gain realized from the purported sale of its contract with FNCB as long-term capital gain. The respondent asserted deficiencies for such year on the basis that IFF (U.S.)'s sale of the contract to Amsterdam was a sham and the gain therefrom should have been reported as short term. In the alternative, he asserted the short sale was a hedging transaction and the gain should have been taxable as ordinary income.

## OPINION

The petitioner both directly and indirectly through its foreign affiliates was engaged worldwide in the preparation and distribution of flavoring extracts. During the latter part of 1966, the petitioner became concerned that a devaluation of the English pound sterling would adversely affect, at least on paper, petitioner's investment in its second-tier subsidiary, IFF (G.B.), which was organized and operated in the United Kingdom. In an effort to protect against that risk, petitioner entered into a short sale contract with FNCB on December 29, 1966, whereby it sold 1.1 million British pounds sterling at the rate of \$2.7691 per pound for delivery on January 3, 1968.

On November 18, 1967, of the succeeding year, the pound was devalued in terms of the U.S. dollar from \$2.80 to \$2.40.

On December 20, 1967, only a few days prior to the closing date of the contract, petitioner purported to sell its contract to Amsterdam for \$387,000, treating

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such amount as long-term capital gain from the sale of a capital asset held for more than 6 months. That same day Amsterdam made an offsetting purchase of the 1.1 million pounds sterling from FNCB at the current exchange rate of \$2.4080, delivery set for January 3, 1968.

On January 3, 1968, both contracts were closed out with Amsterdam realizing a net gain of \$10,210 on the transaction.

At the outset, the Court is faced with the question whether, on the basis of the facts in this case, either the contract entitling the petitioner to sell to FNCB 1.1 million pounds sterling on January 3, 1968, or the subject of that contract, i.e., pounds sterling, constituted a "capital asset" in the hands of the petitioner within the meaning of section 1221. Foreign currency is recognized as "property" as that term is used in the Internal Revenue laws. Such property meets the literal definition of a capital

asset as set forth in section 1221.<sup>2</sup> However, the respondent contends that petitioner's transactions in foreign currency come within the exception to a

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#### SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include--

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by--

(A) a taxpayer whose personal efforts created such property.

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

literal reading of the statute which was carved out under the decision in Corn Products Co. v. Commissioner, supra, and the innumerable cases which followed. See Chemplast, Inc., 60 T.C. 623 (1973).

In response to this argument, petitioner points to the ostensible basis upon which it decided to enter into the short sale contract, namely, as suggested in an internal memorandum, to offset a possible write-down of the net current assets of IFF (G.B.) in preparing the annual consolidated statements of the petitioner and its affiliated corporations in the event of the devaluation of the pound sterling. The amount of pounds sterling to be sold short was supposed to have been calculated with that in mind.

Footnote 2 -- Continued.

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

In determining the effect of the short sale with respect to petitioner's business, this Court is not prepared to accept that memorandum as controlling.<sup>3</sup>

Rather, we must look to the facts. Any diminution in value of the assets of IFF (G.B.) as measured in pounds sterling would be offset by a corresponding reduction in its liabilities, which likewise were payable in pounds sterling. The only loss that the petitioner could sustain was the loss on the conversion into U.S. dollars of the earnings and profits of its British affiliate and, secondly, the loss in U.S. dollars on account of its investment, if any, in the capital stock of such corporation. So long as IFF (G.B.) stayed in business, the latter would never be realized. All the petitioner really accomplished by the short sale of the pounds sterling was to recoup an amount equivalent to the ultimate losses in earnings which might be sustained when and if the

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It should be noted that for accounting purposes the transaction whereby the petitioner realized a gain on the short sale of pounds sterling would have no effect on the consolidated balance sheet except as reflected in the computation of earnings and profits. The petitioner merely realized a nonrecurring gain.

pounds sterling earned by its British affiliate were remitted to the petitioner and converted into U.S. dollars.<sup>4</sup>

In this case, the business of IFF (G.B.) was the business of the petitioner. The loss which the petitioner sought to offset by the short sale of pounds sterling was a loss to which its British affiliate was exposed in its everyday business. Purchases and sales of foreign currency, which in terms of the Internal Revenue Code must be considered as property other than money, for the purpose of offsetting losses which might result from fluctuations in the exchange rates, are part and parcel of a multi-national business. If the petitioner had conducted its foreign business in the United Kingdom through a branch of the parent corporation rather than a British subsidiary, applicability of the Corn Products doctrine to such transaction in foreign exchange could hardly be questioned. The fact that a U.S.

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For tax purposes, any adjustment on account of the devaluation of the pound sterling would be limited to the pounds sterling which might ultimately be remitted to the petitioner. See G.C.M. 4954, VII-2 C.B. 293; Cf. Methods of adjustment with respect to branches, O.D. 489, 2 C.B. 60, and O.D. 550, 2 C.B. 61.

corporation conducts its foreign business through foreign subsidiaries rather than branches, does not necessarily warrant applicability of a different rule.

See e.g. Schlumberger Technology Corp. v. United States, 443 F. 2d 1115 (C.A. 5, 1971).<sup>5</sup>

The short sale of pounds sterling by the petitioner must be regarded as an ordinary income-related transaction and not an "investment." It constituted a loose "hedge" against the risk of future losses of income. See Wool Distributing Corporation, 34 T.C. 323 (1960). If petitioner in this case had closed out its short sale of British pounds in accordance with its contract with FNCL by purchasing pounds at the lower rate resulting from the devaluation, the resulting gain would have been taxable as ordinary income.

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The decision with respect to the applicability of the Corn Products doctrine in the Schlumberger case may appear to be in conflict with a prior decision of the Court of Claims in KVP Sutherland Paper Company v. United States, 344 F. 2d 377 (Ct. Cl. 1965), in that the Court of Claims there found that the loan in Canadian currency by the taxpayer to its subsidiary and the subsequent repayment thereof in kind was a "capital transaction." However, since that court proceeded to tax the gain realized at each step of the transaction either as ordinary income or as a short-term capital gain, the net result was the same.

Wool Distributing Corporation, supra; America-Southeast Asia Co., 26 T.C. 198 (1956). See also Corn Products Co. v. Commissioner, supra; Commissioner v. Farmers & G C. Oil Co., 120 F. 2d 772 (C.A. 5, 1941), reversing 41 B.T.A. 1083 (1940), certiorari denied 314 U.S. 683 (1941). The fact that petitioner chose to sell the contract instead does not change the character of the transaction.

In view of our decision with respect to the applicability of the Corn Products doctrine, it is not necessary to decide the alternative question whether the petitioner has met its burden of proving that the transaction between the petitioner, Amsterdam and FNCB was not in substance a purchase by the petitioner of pounds sterling to meet its obligation under the short sale, thereby making the gain taxable under the provisions of section 1233. In view of the sequence of events, however, it is clear that Amsterdam did not intend to assume any risk. In the absence of any testimony from the representatives of Amsterdam, suffice

it to say that its role appears to be more nearly that of the broker than a purchaser. Cf. Frank C. LaGrange, 26 T.C. 191 (1956).

Decision will be entered  
under Rule 155.

Reviewed by the Court.

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TANNENWALD, J., concurring: I agree with the result reached by the majority, but on a different basis, namely, that petitioner realized a short-term capital gain. In so concluding, I eschew issues relating to the reaches of the "integral part of the business" doctrine upon which Corn Products Co. v. Commissioner, 350 U.S. 46 (1955), is founded and to the applicability of section 1233, either directly or by analogy, to transactions of the type involved  
<sup>1</sup> herein. Rather, I rest my conclusion upon the factual basis that Amsterdam was in reality acting on behalf of petitioner in contracting to purchase pounds from the First National City Bank, that, in effect, such contract to purchase was used to close IFF's short position with First National City Bank on December 20, 1967 with the result that IFF became absolutely entitled to payment of the amount of the difference between \$2.7691 and \$2.4080 per pound, and

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<sup>1</sup>

See also Duncan, "Lowering the Value of the Dollar Raises Certain Tax Problems," 37 J. Taxation 115 (1972).

that such amount represented short-term capital gain to IFF, the assignment of which to Amsterdam did not divest IFF of liability for tax on such gain.

My conclusion is founded upon a careful analysis of the facts revealed -- or, to put it more correctly, not revealed -- by the record herein, in light of the well established principle that the taxpayer has the burden of proof. Welch v. Helvering, 290 U.S. 111 (1933); Albino v. Commissioner, 273 F.2d 450 (C.A. 2, 1960), affirming per curiam T.C. Memo. 1959-1; Rule 142, Tax Court Rules of Practice and Procedure. The contract to purchase pounds between Amsterdam and First National City Bank, the notifications by IFF and Amsterdam to First National City Bank of Amsterdam's "purchase" of the 1966 contract between IFF and First National City Bank, and the acknowledgement of First National City Bank to Amsterdam are all dated the same day, namely,

December 20, 1967. The acknowledgement by First National City Bank to Amsterdam is very revealing. I quote it in full:

In reply to your letter of December 20, 1967, this is to confirm that we have agreed to your purchase from International Flavors and Fragrances Inc. their contract with us wherein they have sold to us on December 29, 1966 Pounds Sterling 1,100,000-0-0 for delivery on January 3, 1968 at the rate of \$2.7691 per Pound. We also wish to confirm that we shall credit your Dollar Account with us on January 3, 1968 the dollar difference between our original purchase price of \$2.7691 per Pound and the rate of exchange applied to your purchase from us of Pounds Sterling 1,000,000-0-0 to close this contract out.

We have also received a letter from International Flavors and Fragrances Inc. confirming their sale of this contract to you.

Awaiting your further instructions in connection with closing out this contract.

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A longhand notation to this letter reads as follows: "bt. Lsl,100,000 forward 1/3/68 at 2.4080 12/20/67 4:30 p.m."

The only evidence as to the foregoing documents relates to the source of the three documents which set forth the arrangements between First National City Bank and Amsterdam, namely, that they came from the files of the bank. The record is totally silent as to the extent of IFF's knowledge, if any, of the arrangements. The only witness was IFF's comptroller, who was not employed by IFF until 1970 (long after the transactions involved herein occurred) and therefore was not competent to testify as to such knowledge. Under these circumstances, I cannot conclude, as petitioner, who has the burden of proof, would have us do, that "[n]o arrangement was made between IFF and Amsterdam to purchase pounds to close the short sale." Indeed, given the clear confirmation in the letter from First National City Bank to Amsterdam with respect to the crediting of the latter's purchase obligation, I think it reasonable to infer that the existence of Amsterdam's contract to purchase pounds was a precondition of the purported

acquisition of the short sale contract from IFF and that an immediate offset of the two obligations was intended with the crediting of the differential in price on January 3, 1968, the only act remaining to be performed.<sup>2</sup>

The cases relied upon by petitioner, dealing with the assignment of anticipated profit from the transfer of preferred stock, bonds, or notes to the issuing corporation, are distinguishable. In those cases, the right to receive the profit was close -- indeed, very close -- to fruition, but had not yet become a fixed legal right to receive payment. Stanley D. Beard, 4 T.C. 756 (1945); W. P. Hobby, 2 T.C. 980 (1943); Clara M. Tully Trust, 1 T.C. 611 (1943); John D. McKee, Et Al., Trustees, 35 B.T.A. 239 (1937). See also Conrad N. Hilton, 13 T.C. 623 (1949). The "near but yet so far" distinction upon which such

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It makes no difference, for the purpose of this case, whether we view the transaction as an accrual in 1967 in favor of IFF (an accrual-basis taxpayer) of a short-term capital gain deriving from the right to receive \$397,000 as a result of the transfer of the contract to purchase pounds to the First National City Bank in exchange for the termination of the short-sale obligation plus the right to receive cash followed by the immediate sale of that right for \$387,000, giving rise to a short-term capital loss of \$10,000, or the anticipatory assignment by IFF of a fixed, although not technically "accrued," right to receive the profit from the closing of the short sale for \$387,000.

decisions are posited stands sharply revealed when considered in light of the authorities which hold that a taxpayer cannot divest himself of capital gain to which he has become entitled as a result of an irreversible corporate liquidation or sale of stock. Kinsey v. Commissioner, 477 F. 2d 1058 (C.A. 2, 1973), affirming 58 T.C. 259 (1972); Hudspeth v. United States, 471 F. 2d 275 (C.A. 8, 1972); Rollins v. United States, 302 F. Supp. 812 (W.D. Tex. 1969); Stephen S. Townsend, 37 T.C. 830 (1962). Compare Simmons v. United States, 341 F. Supp. 947 (M.D. Ga. 1972); W. B. Rushing, 52 T.C. 888, 896-898 (1969), affd. 441 F. 2d 593 (C.A. 5, 1971). -

Nor is petitioner helped by such cases as Joseph Maloney, 25 T.C. 1219 (1956), Morris Shanis, 19 T.C. 641 (1953), affirmed per curiam, 213 F. 2d 151 (C.A. 3, 1954), and Pacific Affiliate, Inc., 18 T.C. 1175, 1221 (1952), affirmed per curiam, 224 F. 2d 578 (C.A. 9, 1955). In those cases, the subject matter was of a nonmonetary character, and the purchase and sale transactions were treated separately by the parties and were consummated through public stock or commodity exchanges. Additionally, with the possible exception of

Shanis, the purchase and sale arrangements were between the taxpayer and different parties. Lack of identity of parties also existed in Frank C. LaGrange, 26 T.C. 191 (1956). Given the foregoing complicating elements, offsetting was either impossible or considered inappropriate.<sup>3</sup> No such obstacles to immediate offsetting exist herein. In this case, the transactions were privately arranged and consummated, and the First National City Bank was a party to both the sale contract and the purchase contract (acquired at the same time as the transaction between IFF and Amsterdam occurred) and treated the two contracts as offsetting items with, for aught that appears in the record herein, IFF's knowledge and participation.<sup>4</sup> These critical facts distinguish the instant situation from that which might have obtained if the record had revealed that IFF simply sold its short-sale contract, leaving it to the subsequent exercise by Amsterdam of its discretion whether to resell it, buy pounds in anticipation of closing it, or do neither in the hope that a change in

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<sup>3</sup> Lack of identity of parties made it necessary for this Court, in LaGrange, to articulate its decision in terms of the continued liability of the taxpayer in order to find the necessary agency relationship, a distinguishing factor upon which petitioner heavily relies.

<sup>4</sup> As a consequence, the absence of continued liability by IFF becomes totally irrelevant. See footnote 3, supra.

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the exchange rate would increase its profits. In this connection, I am constrained to note that the opportunity for offsetting, which I consider to have existed in the instant case, would not necessarily have been avoided if Amsterdam had contracted to purchase the pounds from a source other than First National City Bank; in such a situation, it would still be pertinent to inquire as to the involvement of First National City Bank in order to determine whether a circuitous form of transaction was utilized to camouflage the application of the offset rationale.

Finally, I consider inapposite Stavisky v. Commissioner, 291 F. 2d 48 (C.A. 2, 1961), affirming 34 T.C. 140 (1960), also cited by petitioner to support its position. There, to be sure, there were two "when, as, and if issued" transactions -- one a sale and the other a purchase -- between the taxpayer and the same person. But these two transactions occurred practically simultaneously at the very outset<sup>6</sup> and they were treated separately by the parties involved, including disposition in two different taxable years. More

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By virtue of the purchase of the same amount of pounds at \$2.4080 per pound, any subsequent fluctuation in the value of the pound was totally without effect upon the amounts to be received or paid by IFF, Amsterdam, or First National City Bank.

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Under such circumstances, they were akin to "arbitrage." Cf. section 1233(f).

importantly, the issue in that case was framed in terms of whether a payment by the taxpayer upon the transfer of the contract of sale was an ordinary loss or a capital loss -- an issue which turned upon whether the taxpayer had made a sale or a payment in exchange for a cancellation of a liability. After finding that section 117(1) of the Internal Revenue Code of 1939 (the predecessor of section 1233) was inapplicable because the transactions occurred prior to its enactment, this Court held that all that had been sold was the "when, as, and if issued" sale contract which had been held for more than six months. Indeed, the rejection of the taxpayer's claim for an ordinary loss, based upon its release from liability by the other party to that contract, coupled with the fact that the taxpayer did not, at that time, transfer the "when, as, and if issued" purchase contract, lends support to treatment of the facts in this case as a transfer of a capital asset by IFF, namely, the offsetting contract to purchase pounds -- an asset which had clearly been held only momentarily. See footnote 2, supra; Raymond B. Haynes, 17 T.C. 772, 777, n. 2 (1951). Compare KVP Sutherland Paper Company v. United States, 344 F. 2d 377, 383 (Ct. Cl. 1965); Loewi & Co., 23 T.C. 486,

489-490 (1954), affirmed on other grounds, 232 F. 2d 621 (C.A. 7, 1956). See also Skelton, J., concurring in Gillin v. United States, 423 F. 2d 309, 314-316 (Ct. Cl. 1970).

GOFFE and WILES, JJ., agree with this concurring opinion.

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HALL, J. I respectfully dissent, believing the gain to be long-term capital gain.

Fearing diminution of the dollar value of its stock in its British subsidiary in the event of devaluation of the pound, petitioner acquired by contract the right to sell to City Bank 1,100,000 pounds at \$2.7691 per pound. This contract right, I believe, was a capital asset. It clearly is not excluded from the definition of that term under the literal language of section 1221(1). Although respondent asserts, and the Court holds, that the contract is caught within the sweep of the Corn Products doctrine, this cannot be so. Corn Products teaches that capital gain treatment is reserved for "transactions in property which are not the normal source of business income." 350 U.S. 46, 52 (1955). The contract here and the property (pounds) were clearly not the normal source of petitioner's business income. There is no indication that the transaction was recurring. As such, it was unlike that in Corn Products. Intended, as the majority finds it was, to offset possible anticipated decline in the dollar value of the sterling subsidiary's stock, the transaction was more closely related to that stock, a capital asset in petitioner's hands, than to the subsidiary's routine business operations. While the

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majority refers to currency hedges as "part and parcel of a multi-national business," there is no evidence that this transaction was routine or customary for petitioner. Furthermore, nothing in the evidence or findings justifies us in ignoring the separate corporate identities of petitioner and its subsidiary. The business of the subsidiary was not that of the parent. National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949); Moline Properties v. Commissioner, 319 U.S. 436 (1943).

Since the contract was a capital asset, concededly held for more than six months, long-term capital gain treatment was appropriate if the disposition of the contract on December 20, 1967 constituted a sale. Section 1222(3), I.R.C. 1954. On this issue I respectfully disagree with the concurring opinion. After the devaluation the contract right to sell pounds for more than their value was a valuable and readily marketable asset. No shenanigans or special deals were required to sell it, and we have no evidence either occurred. While the purchaser, Amsterdam, froze its profits by simultaneously hedging, there is no reason this circumstance should convert petitioner's sale into something else. Petitioner clearly divested itself of all

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title to, and realistic further concern regarding, the contract, and became unconditionally entitled to the price. No more is required for a "sale," which has the same meaning in tax law as in ordinary parlance. Commissioner v. Brown, 380 U.S. 563 (1965); Helvering v. Flaccus Leather Co., 313 U.S. 247 (1941). Petitioner's

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failure to prove its lack of knowledge of what Amsterdam planned to do with the contract is immaterial, for such knowledge could not add to or subtract from the finality of petitioner's disposition. The concurring opinion also refers to petitioner's failure to prove absence of "participation" in the Amsterdam-City Bank arrangement, but the record is clear enough to support, indeed to require, the Court finding as a fact that the participants in that transaction were Amsterdam and First National City Bank. Moreover, petitioner could properly claim unfair surprise if taxed with the concurring opinion's theory that it failed to disprove that Amsterdam acted as petitioner's agent. Respondent's counsel, in his opening statement, admitted that "IFF transferred its agreement with First National City Bank to Amsterdam Overseas Corporation for \$387,000." This admission, while in effect belatedly retracted by respondent's advancing a new theory at a second trial session, is quite inconsistent with any notion of IFF's subsequent retention of ownership. Accordingly, I would find that a sale took place and the gain was long-term capital gain. See Conrad N. Hilton, 13 T.C. 623 (1949); Stanley D. Beard, 4 T.C. 756 (1945); Clara M. Tully Trust, 1 T.C. 611 (1943).

FORRESTER and STERRETT, JJ., agree with this dissent.

UNITED STATES TAX COURT

INTERNATIONAL FLAVORS & FRAGRANCES INC. )  
Petitioner, )  
v. ) Docket No. 7768-70  
COMMISSIONER OF INTERNAL REVENUE, )  
Respondent. )

DECISION

Pursuant to the opinion of the Court filed May 16, 1974, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there is a deficiency in income tax due from the petitioner for the taxable year 1967 in the amount of \$73,715.00.

(signed) William H. Quaely

Judge.

Entered: OCT 15 1974

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

*George Rowe Jr.*

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OCT 7 1971

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UNITED STATES TAX COURT

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INTERNATIONAL FLAVORS & FRAGRANCES INC., :

Petitioner-Appellant,

Docket No. 7768-70

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

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NOTICE OF APPEAL

Notice is hereby given that INTERNATIONAL FLAVORS & FRAGRANCES INC., petitioner-appellant named above, hereby appeals to the United States Court of Appeals for the Second Circuit from the decision of this Court entered in the above captioned proceeding on the 15th day of October, 1974.

Dated: January 3, 1975  
New York, New York

*GeoRowe Jr*

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